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SPENDING ON CHILDREN AND THE ELDERLY

AN ISSUE BRIEF BY

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Summary

The United States spends 2.4 times as much on the elderly as on children, measured on a per capita basis, with the ratio rising to 7 to 1 if looking just at the federal budget. The tilt toward the elderly is stronger in the United States than in many other countries, although all OECD countries spend more, per capita, on the elderly than on children. Viewed from a life-cycle perspective, it is not unfair to spend more on the elderly than on children because all individuals progress from being children to working-age adults to elderly adults. However, our current system of public expenditures is unfair to younger generations, defined as birth cohorts rather than age groups: the vast and growing size of unfunded health and retirement benefits will require today's children to bear a heavy tax burden when they grow up to be working-age adults. For our children's sake, we should restrain growth in elderly benefits and pay our share of taxes.

Spending on Children and Elderly. This issue brief is drawn from a series of three working papers on spending on children and the elderly. The first, *How Much Do We Spend on Children and the Elderly?*, is descriptive in nature and provides estimates of public spending on children and the elderly, as well as information on private support for these two age groups. The second, *A Comparative Perspective on Public Spending on Children* investigates whether the United States invests less in children than other rich countries and whether there is a common cross-national pattern of spending more on elderly than on children. Finally, the third paper, *Public Spending on Children and the Elderly from a Life-Cycle Perspective*, tackles a challenging question raised by the observed spending patterns in the earlier papers, namely: does it make sense for our country to be spending so much less on children than on the elderly? While such a question sometimes raises issues of intergenerational warfare, the paper addresses it through a life-cycle framework. The papers, which provide further detail and references for the information summarized in this brief can be found here on the Brookings website.

The author of the series, Julia B. Isaacs, is the Child and Family Policy Fellow at the Brookings Institution. The papers benefited from the excellent research assistance of Emily Monea and the helpful comments of Isabel Sawhill and Ron Haskins.

Introduction

Despite the strong interest most Americans have in the well-being of children, federal spending on children is relatively modest in comparison with federal spending on the elderly. Moreover, the amounts being spent on health care and pensions for the elderly are growing at a frightening pace. The Congressional Budget Office projects that spending on Social Security, Medicare and Medicaid could reach over 18 percent of GDP by 2050, a level that could easily consume all federal revenue under current tax law. If no policy actions are taken, future policy-makers will face the choice of zeroing out *all* other spending, raising taxes to unprecedented levels, cutting the major entitlement programs dramatically, running up the federal debt to ruinous levels, or a combination of all of the above.

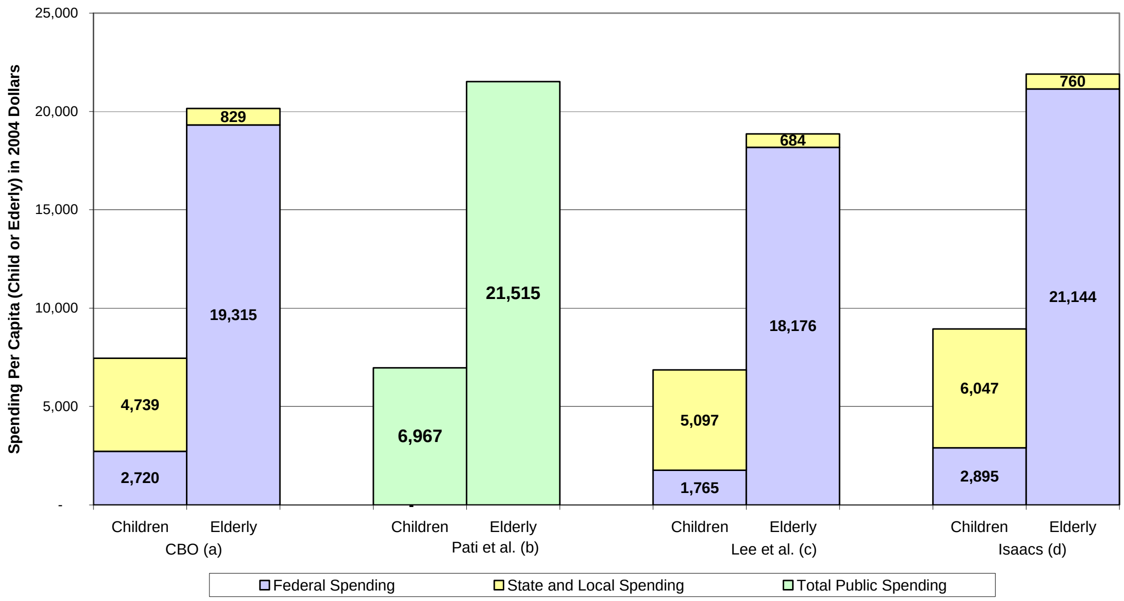
This study of spending on children and the elderly is motivated by concern about the nation's long-term fiscal problems, combined with my long-standing interest in child policy. My goal is to shed light on the budget choices facing the nation by integrating basic facts on public expenditures on children and the elderly with less well-known research on private expenditures and international patterns of public expenditures. In doing so, I consider differences in spending between children and the elderly, not from the lens of intergenerational warfare, but from the perspective of the human life-cycle and the natural stages of development we all share as we move from being children to working-age adults to elderly adults.

Public and Private Spending on Children and the Elderly

As shown in the first of three papers on this topic, public spending on children averaged $8,942 per child under age 19 in 2004. More than two-thirds of this spending was from state and local governments, driven by spending on public elementary and secondary education. In the same year, public spending on the elderly was $21,904 per elderly person, or 2.4 times the amount spent per child. The vast majority of public spending on the elderly is federally funded, primarily through Social Security and Medicare. As such, the tilt toward the elderly is much higher if one looks just at the federal budget, with an elderly person receiving $7 for every dollar received by a child.

My estimate of public spending on children is based on my previous research on federal expenditures on children conducted with co-authors at the Urban Institute and a Rockefeller Institute analysis of state and local spending on children. My analysis of spending on the elderly is less extensive, so my estimate of elderly spending may be an underestimate. Indeed, as shown in figure 1, three other studies find slightly higher ratios of elderly-to-child spending, ranging from 2.7 to 3.1 to 1 for total public spending and 7 to 10 to 1 for federal investments.

Figure 1. Per Capita Spending on Children and the Elderly, Various Estimates (in 2004 Dollars)



Sources and notes:

a) The CBO estimate focused on federal expenditures in 2000 but included references to $4,000 in state and local spending per child and $700 in state and local spending per elderly person in 1995; these state and local estimate have been adjusted for inflation and included here, CBO (2000).

b) Estimates are for the year 2000 from Pati et al., 2002.

c) Estimates are for 2002 and are from a spreadsheet analysis of Ronald Lee and colleagues (G. Donehower, personal communication, October 9, 2006).

d) the author's estimates are for 2004 and based on the methodology described in text.

Parents' primary responsibility for raising their own children is often offered as justification for lower public spending on children relative to the elderly. Indeed, parents do contribute 50 to 60 percent of total monetary investments in children, on average, according to my estimates and those of three other researchers. Yet the elderly also have private as well as public sources of support.

Public expenditures on the elderly, while substantial, fund only 37 percent of their total consumption, on average, according to an analysis by Andrew Mason, Ronald Lee, and colleagues. Private transfers from adult children and other family members are even smaller, representing only 7 percent of total expenditures. The primary support for the elderly comes not from the government or their families but from their own savings (earnings on accumulated wealth and liquidation of assets), which finance more than 55 percent of total per capita elderly consumption.[1] This funding source (spreading one's earnings over time through asset accumulation) is generally not available to children, who only rarely are able to borrow credit against future earnings (e.g., taking out loans for college at the end of one's childhood years).

[1] The elderly also have positive income from labor (+15 percent) and negative income through bequests (-15 percent), as detailed further in Isaacs (2009a), based on an analysis of 2000 data by Mason, Lee, Tung, Lai, and Miller (2006).

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High levels of private support for both the elderly and children raise the question as to why public support should be so much higher for the elderly than for children. In a much-circulated speech made in 1984, demographer Samuel Preston argued that rising spending on the elderly and improved elderly well-being reflects the growing political power of the elderly, who make up a growing share of the electorate. Moreover, he suggested that the rise in public expenditures on the elderly may come at the expense of children, raising the specter of intergenerational warfare. Cross-national research, however, finds relatively little evidence to date that supports Preston's concerns.

International Comparisons of Spending on Children and the Elderly

Research reviewed in the second paper in this series shows that all OECD countries spend more, per capita, on cash benefits for the elderly than on cash benefits for families and children. Moreover, the tilt toward the elderly is particularly strong in the United States. However, several studies have failed to find a decline in spending on children as elderly populations and expenditures on the elderly have increased. On the contrary, per capita expenditures on children and families increased during the latter part of the twentieth century in most rich OECD countries. In fact, a recent study by Janet Gornick found that family cash expenditures per child grew at a *faster* rate than old-age spending per elderly person in some countries, including the United States, in direct contradiction to the Preston thesis. Gornick, does not dismiss Preston's concerns completely, however, warning that the situation could change in the future. Her general findings of growth in child benefits despite population aging may reflect an overall expansion in social expenditures during the time period studied (1980-1995). Moreover, her analysis of the minority of countries where per capita spending on children did fall suggests that children's spending is at higher risk of being crowded out in situations with a skyrocketing elderly-to-child ratio or where the growth in overall social expenditures comes to an end. In other words, while population aging has not had a discernible negative effect on the allocation of resources to children and families in OECD countries to date, there are reasons to worry that this may change in the future.

I also compare public spending on children in the United States to spending levels in other countries. Cash and near-cash benefits for children in the United States are quite low compared to most other rich, industrialized nations, and much of the literature focuses on this measure of spending on children, contributing to the conventional view of the United States as tight-fisted with regard to social welfare spending. However, the picture changes radically when education and health expenditures are brought into the equation. Spending on public education is relatively high in the United States, so combined expenditures on benefits to families and education in the United States are somewhere between the mid-level to high range for OECD countries. Finally, if one defines social investments in children to include spending on health – and health is defined to include both employer-provided benefits as well as government expenditures – the United States emerges as a country with much higher than average investments in its children.

A Life-Cycle Perspective on Spending on Children and the Elderly

In my third and final paper, I examine patterns of public expenditures on children and the elderly from a life-cycle framework. The life-cycle framework views the natural progression of human development as consisting of three basic stages: childhood, when one is dependent on others;

working-age adulthood, when one generates sufficient income to support oneself and others; and old age, when one is retired and dependent on a combination of personal savings, public transfers from the government, and support from younger family members.

From this life-cycle perspective, the two dependent groups who are unable to live off their own labor income – children and the elderly – must be supported by some combination of public and private support if society is to sustain itself and prosper. The type and size of intergenerational transfers can vary significantly, however, across societies.

One can imagine members of a society rationally entering into a social compact under which each adult generation offers to invest in the education of the childhood generation, in return for future payment of retirement benefits to the parent generation when the children become working-age adults. In a 1988 article, Gary Becker and Kevin Murphy suggest that such a social compact provides a rational model for the American system of public expenditures, even though annual retirement benefits exceed annual education benefits by a factor of two or three. This inequality is not unfair to any individual, however, because over a full life-span, the average individual will receive both children's and elderly benefits – and will pay out taxes during the intervening working years to support the education and retirement of the preceding and succeeding generations.

Such a social compact serves to smooth income over the life-cycle, providing extra income during life stages when individuals are too young or too old to support themselves through work. In addition, this system of intergenerational transfers improves economic efficiency because the increased investment in human capital during childhood increases the productivity of working-age adults, thereby increasing the overall size of the economic pie to be shared.

While the real world is much more complex than the simple model outlined above, the actual allocation of benefits and taxes by age in the United States is indeed largely shaped by education benefits to children, taxes from working-age adults, and retirement-related benefits to the elderly, as shown in figures 2a and 2b, drawn from the research of Ronald Lee and Ryan Edwards. Note, however, the large role played by health as well as traditional retirement benefits in swelling the size of benefits to the elderly.

Figure 2a. Benefits by Age

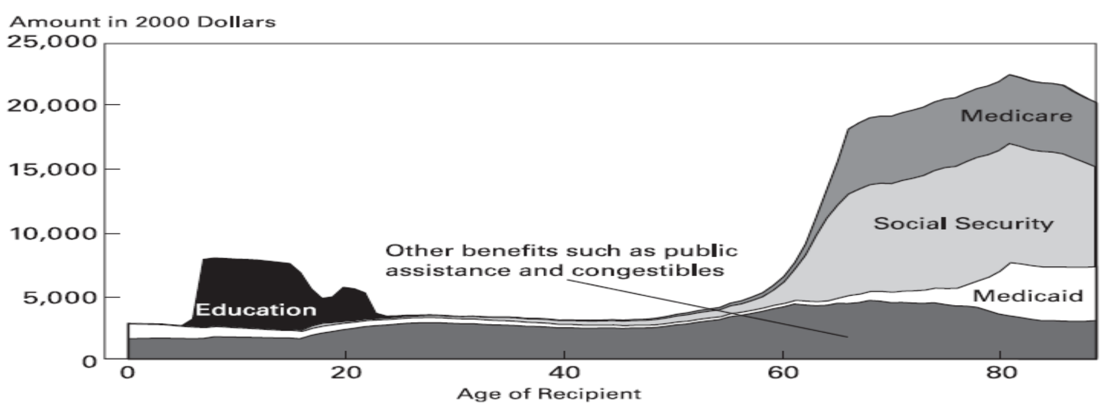

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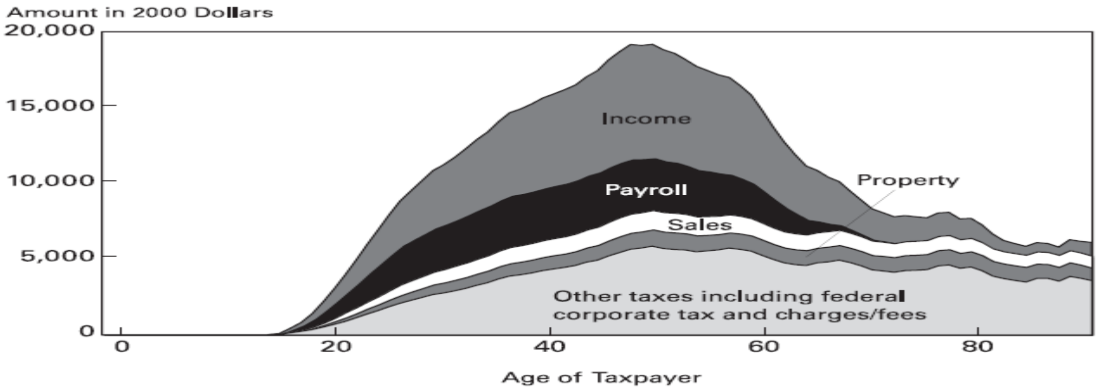
Figure 2b. Taxes by age



Source and notes: Lee and Edwards (2001), Figures 3 and 4. Lee and Edwards' analysis is based on data from the March Current Population Surveys of the U.S. Bureau of the Census for years 1994 and 1995; the data has been inflated to 2000 levels. Congestibles include transportation, public safety, and other benefits that assumed to benefit all ages equally.

The simple social compact outlined by Becker and Murphy suggests that a system of public expenditures with higher payments in later years could be a rational intergenerational transfer system, serving to improve economic efficiency through increased investment in human capital as well as smoothing income over the life-cycle. However, as the elderly live longer and have higher retirement and health expenses, the basic mathematics of the model may be thrown out of whack, placing higher and higher tax burdens on working-age adults (and the children who are the next generation of working-age adults). That is, there is now a new intergenerational equity question. It is no longer, "Is it fair to spend less on children than on the elderly," but "Are some generations unfairly burdened by high taxes?" This intergenerational equity question does not concern equity across age groups (e.g., children and elderly) but across age cohorts (e.g., those who receive retirement benefits today compared to those who will receive them twenty, forty or sixty years from now).[2]

In fact, the system of intergenerational transfers in the United States is not equitable across generations, according to economists who use sophisticated accounting methods to measure spending allocations and tax burdens across generations. A wide range of generational accounting estimates suggest that the tax burden on future generations will be much higher than current tax rates, with some calculations showing a doubling in lifetime net tax rates for future generations. The lion's share of the problem is attributed to rising costs for retirement and health benefits under Social Security, Medicare, and Medicaid, with spending under these three programs is projected to reach 18 or 19 percent of GDP by 2050, a share of the economy equivalent to the entire federal budget in 2007.

Intergenerational equity is a particularly salient issue at the current time because we have no plan for how to share the increased costs of health and retirement benefits across the different generations. Faced with the uncomfortable choice between raising taxes or cutting benefits, we

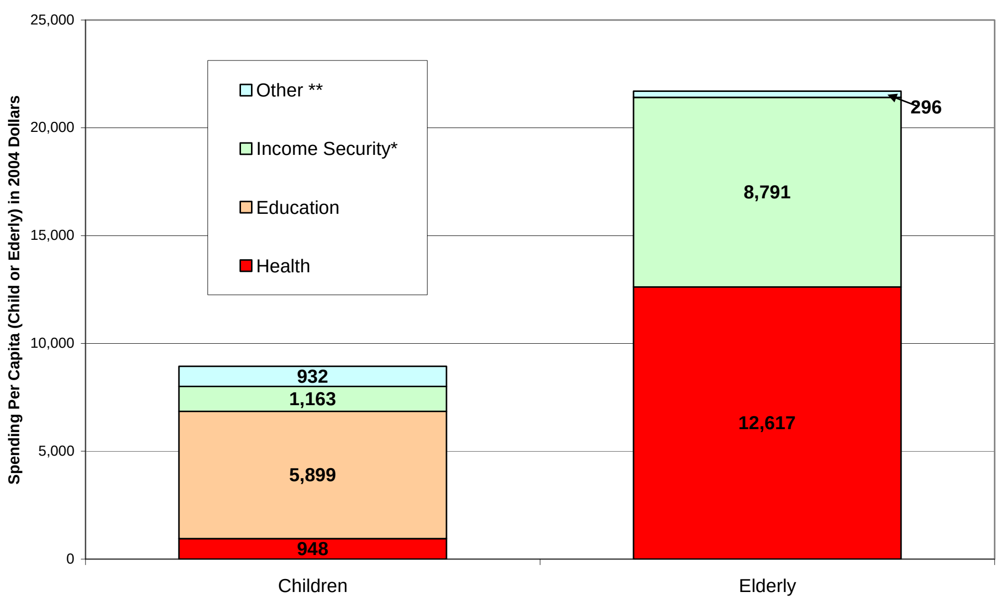
[2] The word "generation" is vague enough that these two different concepts are often merged together in public debate and political discourse. However, the distinction is important. For example, proposals to stem the growth in Medicare benefits over the next 20 years will have more of an impact on those who are 45 today than those who are currently elderly.

keep falling back on using debt to finance benefits that have not yet been paid for. This is not fair to future generations. The infant child entering the Becker-Murphy social compact will not be getting a fair deal if he has to pay for his parents' health and retirement benefits *and* the unpaid loan for his grandparents' health and retirement benefits.

While intergenerational inequity is the major critique of our current system of intergenerational transfers, it also is important to consider whether the United States invests sufficiently in human capital during childhood. The importance of human capital investments early in life was highlighted in the work of Becker and Murphy and also emerges from a more general consideration of the progression of individuals through the life-cycle. The future well-being of those of us working today is dependent on the work effort, productivity, and taxes of those who will be working when we are retired.

Almost two-thirds of all public investments in children in 2004, or $5,899 per child, were in the area of education, an area in which there is indeed good evidence of positive effects on an individual's earnings and a country's overall economic growth. Spending on early childhood education, however, is very small, despite the documented long-term economic benefits of high-quality early intervention programs. Public investments in child health, another area with considerable long-term payoffs, is also relatively low, $948 per child, a fraction of the $12,167 per capita spent on elderly health (see figure 3).

Figure 3. Per Capita Spending on Children and Elderly, by Category



Source: Isaacs (2009c), based on estimating methodology described in Isaacs (2009a). * Income security includes refundable tax credits; **Other includes nutrition, housing and social services.

The vast majority of elderly expenditures are not investments in the future but rather support of current consumption, through Social Security and other income supports as well as spending on health care. Thus, as federal budgets become more and more dominated by spending on the elderly, they are also tilted more toward the support of current consumption rather than investment in the future. Such a tilt seems short-sighted in view of the importance of human capital investments for supporting economic growth in the future.

An investment perspective is certainly not the only rationale for government spending. The government also plays a critical role in assisting individuals during times of unemployment, disability, retirement or poor health, not to mention the need to spend funds for national security, transportation and other priorities. Yet, without overstating the priority to be placed on investment, some level of investment must be maintained even as the growing size of the health and retirement benefits slants public expenditures more and more toward consumption.

Finally, in addition to treating generations equitably and fostering investment in human capital during childhood, a third criterion for judging an intergenerational social compact is suggested in my third paper. The transfer system should smooth out income over the life-cycle, providing extra income during life stages when individuals are too young or too old to support themselves through work. As shown in figure 3, spending on income security is much higher for elderly persons ($8,791 per capita) than for children ($1,163 per capita under a broad definition of income security that includes refundable tax credits). One justification for this large difference is that parents are expected to provide for the majority of children's needs, while family members contribute little to the support of the elderly, who are thus much more reliant on public pensions as well as personal savings. While this is true, it also is true that parents have unequal incomes, and some parents do not have sufficient income to protect their children from economic hardship. Some elderly do not have sufficient savings and also suffer from economic deprivation, but not at the same rate as children, as can be seen from poverty and hardship statistics.

Child poverty rates are almost twice as high as elderly poverty rates, 19.0 percent compared to 9.7 percent in 2008. Children were also much more likely to live in households that had extensive worries about running out of food or exhibited other measures of low food security (4.3 vs. 1.8 percent in 2007). Thus, while one would not want to ignore the problem of poverty among certain groups of the elderly, as a whole, children are at greater risk of material hardship and poverty than the elderly.

Child poverty rates in the United States are also higher than in other rich countries. Inequality in parental earnings and high rates of single-parent families provide a partial explanation. Young working parents in the United States often have insufficient earnings to raise their families above the poverty level, and this is particularly likely in the case of single parents. In addition, cash transfer and tax policies in the United States are less effective in reducing child poverty than benefits and taxes in many OECD countries according to evidence from cross-national studies reviewed in the second paper. Concern about the economic well-being of children thus joins interest in prudent investment as a rationale for targeted increases in spending on children.

Conclusion and Policy Implications

This analysis of spending on children and the elderly was motivated by concern about the nation's long-term fiscal problems. Little progress is being made in addressing the fiscal imbalances in the federal budget because political leaders fear that any changes to entitlement programs will be viewed unfavorably by the electorate as attacks on the elderly and our system of social insurance. Indeed, policy-makers face a formidable challenge in trying to impose limits on spending while preserving the essential features of Social Security, Medicare and Medicaid, which have protected the elderly against poverty during their retirement years and provided both elderly and disabled citizens with access to medical care. Yet this challenge is not insurmountable. If there were sufficient political will to re-examine the allocation of federal and other governmental resources, we could figure out how we can meet the real needs of elderly and disabled citizens without so overwhelming our fiscal capacity that we run completely out of resources for children and other priorities. Looking at the budget from a life-cycle framework provides the future-oriented perspective that may help us in addressing the structural imbalances built into current spending and tax policies.

When examined from a life-cycle perspective, the question of appropriate spending levels for children and the elderly is transformed from one of equity to one of prudent allocation of resources because children and the elderly are not distinct groups but rather in different stages of the life-cycle. In this context, the question of spending on children and the elderly becomes a question of supporting investments in human capital in the early years and supporting consumption in later years. In addition, taxes must be set appropriately in the middle years so that the entire system of intergenerational transfers can be sustained over time and provide roughly equal burdens to different generations, even amidst changes in the age structure of the population and benefit costs. Ideally, the entire system of public transfers would be designed so as to complement and strengthen private systems of intergenerational transfers, which also are evolving over time.

Our current system of public and private expenditures over the life-cycle needs some modification. Society as a whole would benefit if we invested more in human capital during childhood, particularly in the areas of early childhood development and preventive health care. There also are too many children living in poverty, suggesting a need to improve public benefits if we are unable to address broader issues related to income inequality. The major flaw of our current system of intergenerational transfers, however, is the vast and rapidly growing size of public expenditures on health and retirement benefits for the elderly. Such expenditures are problematic, not because it is wrong to spend more on the elderly than on children, but because it is wrong to spend at levels that are becoming so high that they will crowd out spending at other stages of life and place a heavy tax burden on the children of today when they grow up to be working-age adults.

It is time for us to take steps to curtail the projected growth in spending on the elderly, including changes in Social Security as well as more sweeping changes to our entire health care system. In addition, to avoid large benefit cuts, we need to step up and pay sufficient taxes to maintain the vitality of our health and retirement benefit systems. While few people are eager to cut benefits for the elderly or adjust the current tax structures, fiscal discipline is a gift we should give to our children and grandchildren.

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