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Comments on

Spending on Children and the Elderly: An Issue Brief by Julia Issacs

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Julia's paper raises a fundamental question facing the future of government policy: *to whom* and, to a lesser extent, *to what* do we want to dedicate the future resources that may be available to us. Her paper particularly points to comparisons of what we spend on children and the elderly, a comparison made possible in part because of joint work we at the Urban Institute have done with Julia on the size of the children's budget and how it is projected to change over time.[1] This work has been extended in a variety of exciting ways, including breakdowns by program areas and for some major age groups. Like Julia, I find the most interesting aspects of this work the future direction of spending, as opposed to the past—although the past also informs us of where we may want to go.

Julia's paper today directly poses the question of relative spending on children and the elderly as one of fairness. This raises tough questions about the standards we use and what we mean by fairness. In what Julia presents, and in the comments that Henry Aaron and I make, we sometimes come to judgment based on how we weigh the evidence. So that you may come to your own judgment, we owe it to you to try as best as possible to identify when our judgments are political or economic in nature, whether they are issues of fairness or efficiency or some other standard, and, when it comes to fairness, which equity principle is being referenced: equal justice for equals (or horizontal equity); progressivity; or some benefit tax or individual equity principle under which we get back what we pay to government.

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[1] Macomber, Jennifer, Julia Isaacs, Tracy Vericker, Adam Kent (2010). "Public Investment in Children's Early and Elementary Years" Washington, DC: The Urban Institute and The Brookings Institution.

Kent, Adam, Jennifer Macomber, Julia Isaacs, Tracy Vericker, and Elizabeth Bringewatt, (2010). "Federal Expenditures on Pre-Kindergarteners and Kindergarteners in 2008," The Urban Institute and The Brookings Institution.

Vericker, Tracy, Jennifer Macomber, Julia Isaacs, Adam Kent, and Elizabeth Bringewatt, (2010). "Federal Expenditures on Elementary Age Children in 2008." The Urban Institute and The Brookings Institution.

Macomber, Jennifer, Isaacs, Julia, Vericker, Tracy, Kent, Adam, and Paul Johnson. (2008) "Federal Expenditures on Infants and Toddlers in 2007." The Urban Institute and The Brookings Institution.

Isaacs, Julia, Vericker, Tracy, Macomber, Jennifer, and Adam Kent. (2009). "Kids' Share: An Analysis of Federal Expenditures on Children through 2008." Washington, DC: The Urban Institute and The Brookings Institution.

My own conclusions are as follows:

(1) Many of Julia's concerns are not over fairness but over efficiency and investment. Julia appropriately also raises the efficiency issue: what should we provide people at different stages in their own life cycle to maximize their own lifetime well-being? Shifting the portfolio toward earlier investment would seem to raise both individual and social rates of return. From the investment viewpoint, my conclusions are perhaps even stronger than Julia's: our long-term budget is that of a declining nation.

(2) The too-easy press take-away about intergenerational conflict between the elderly versus children is misleading. The current middle-aged, not the current elderly, are those with the most currently at stake both ways—they are the ones who must decide how much they get versus their children and grandchildren.

(3) Can we avoid Julia's questions by simply asserting that we can always raise taxes to favor both young and old and everyone else as well? No. It is entirely appropriate to ask how the pie should be allocated, whatever the level of revenue collected. Similarly, for every dollar of additional tax raised, we want to know where it can best be spent.

(4) Budget classifications and comparisons are arbitrary, and I have some minor criticisms here, such as inconsistent classifying of who is "old" by using chronological age from birth when we continue to have longer lives. In general, however, I disagree with those who oppose developing budgets for groups such as the young and old. Why wouldn't we want to know who's getting the money? It helps us sort out just how well we are allocating our budget dollars not only between groups but among the programs that affect each group, as well.

(5) One way of posing Julia's topic is to ask whether the nation's budget priority should remain that the average-income couple should retire with about $1.5 million in government benefits in about 25 years versus $900,000 today, while many programs for children wane.[2]

(6) Given the large increases in future health costs, do we need to turn our attention only to health care to get us out of our budget mess? No. Demographics have mattered and do matter a lot. They affect national output, years of taxpaying and years of benefit receipt—not just annual benefit levels in Social Security. When a system moves toward providing one-third of adults support for the last third of their adult lives, it has an impact on what we can afford to do and do well, including what resources we make available for children—with or without unsustainable health cost growth.

[2] This calculation is independent of changes in birth rates, which I discuss later.

(7) A dominant issue, health care, complicates our conclusions about what is fair or not about the distribution of benefits and taxes among different parts of the population. Right now, many of us who are middle age or older continue to get many new benefits arising from new technology, drugs, and procedures. These benefits include longer and healthier lives. Yet our current health and retirement programs force others to pay for costs associated with our gains... I know of no fairness or efficiency standard under which this would be allowed to happen automatically.

Investment and Efficiency

Many of the issues that Julia raises are really not issues of fairness, but of efficiency and investment. From this perspective, I agree with Julia that we should be spending much larger shares of budget growth in areas more likely to produce some positive return, such as education, and smaller shares toward consumption and retiring for such long periods of time.

Regardless of level of spending, I conclude that a standard of progressivity would require us to spend more on the truly old and less on those in late middle age, at least as measured by life expectancy. My own work, for instance, led the way toward consideration of a minimum Social Security benefit to beef up cash benefits for those with lower lifetime earnings. I similarly worry that children's spending, whatever its level, is not well allocated.

From the investment perspective, I would use even stronger language than Julia. I believe that we have a budget for a declining nation. Admittedly, this investment perspective reflects a judgment that our human condition and our genetic make lead us to aspire to leave a better world for tomorrow—that we do not protest but desire that our children be better off than us. Yet our government spending increasingly moves in the opposite direction by supporting our own consumption, and, moreover, does so in a way that discourages work and saving—particularly by encouraging people to retire for one-third or more of their adult lives.

We have already gone so far down the road toward middle-age retirement that any assessment of what is fair or efficient cannot just start with today as a given. In 1940, when Social Security first began, workers retired on average at age 68. If they were to retire today for an equivalent number of years, they would be retiring at age 74, and within a few decades, at age 78. Instead, they retire on average about age 64. Now progressivity, efficiency in redistributing according to need, and practical issues of enforcement all suggest concentrating benefits on years when people are least able to work—among both young and old.[3] I know of no standard of equity or efficiency or

[3] With respect to future labor force, I am more optimistic than many forecasters, including those from the budget offices that both Julia and I have used. Without going into detail, I have suggested for more than a decade that future projections of retirement patterns use a method that fundamentally ignores the demand

investment that says that each generation should garner an increasingly higher share of benefits in years when they least need them.

Having said this, I must admit that children's advocates can often find ways to spend money as badly as can advocates for the elderly. Still, I believe the evidence is overwhelming that paying for such things as teacher's aides in disruptive classroom, higher quality teachers, and for early childhood education will produce a higher return than our current pattern of spending in ways that that encourage people to work less.

The Misleading Label: Children versus the Elderly

It is unfortunate that the issues Julia raises tends to get put under the banner of "children versus the elderly." That type of label tends to arouse interest groups that have very little at stake, such as the current elderly, who are largely grandfathered into the current system. The first group that must seriously face the trade-offs built into the current system are the middle-aged, who must decide whether almost all government growth should be dedicated to them as they approach retirement or a larger share should be devoted to their children.

By the way, many of those who suggest that adjusting the future direction of current law elderly programs somehow violates generational equity or some principle of individual equity or benefit taxation nonetheless support higher levels of taxation such as value-added taxes. The judgment that future higher-income elderly should pay more tax rather than receive lower benefit growth rates seems to me to be a matter of political judgment, perhaps of administration, but not of equity—or, for that matter, efficiency.

How to Spend the Next Dollar of Tax

Another criticism made of studies like Julia's is that we should be raising taxes to support both children and the elderly. That may be correct, but it dodges the question either of how the next marginal dollar should be spent or the related question of whether the shares of any particular expenditure (or tax) pie are appropriate. Henry Aaron and I have gone around on this for years. He says we can afford to pay for the growth in many elderly programs simply by raising taxes, and I say that dodges the question of whether this is the best way to spend those extra tax dollars.

In the ideal, a complete budget exercise would involve zero-based budgeting and include a social benefit-cost calculus for every marginal action we perform, for how each next (or previous, for that matter) dollar should be spent, and whether the marginal cost of the additional tax was also worth the next marginal expenditure. We'd also include tax rates and tax expenditures in the analysis. But we seldom are capable of performing that level of evaluation.

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curve for labor, that the adult employment rate will be higher than usually projected, and that moderate public and private policy changes can go a long way to make this happen.

To deal with these limitations, it is sometimes helpful, as Julia essentially does, to examine shares of the spending pie, not just its overall size. One advantage this approach is that it doesn't allow the issue of whether taxes should be higher or lower to usurp the basic cost-benefit question of whether each additional dollar of spending is allocated in the best way.

The Use of Classifications and Relative Comparisons

Julia makes use of budget classifications for children and the elderly in her brief. Some people have criticized these classifications because they involve some arbitrary line drawing. They are right to a point, but all budget classifications are by their nature limited in what they tell us. My bottom line, however, is that they are still useful. Simply put, calculating a children's budget and a budget for elderly programs gives us a perspective on our spending and tax patterns not otherwise available.

As an extra benefit, such classifications help us not only in comparing among groups, but within each group as well. For instance, do we really want to provide so large a share of elderly benefits in the form of health care? Do we want to continue the discrimination in Social Security against abandoned mothers? Referring again to our many studies on children's spending, do we want the children's budget to be focused on housing subsidies or education? Or on the younger or older of children, when researchers such as Nobel Prize winning economist James Heckman suggests we get higher returns on investing in the very young?

I have some quibbles with the ways that Julia's paper—and most research papers on related subjects—classify who is "old" and the extent to which we classify by income to determine progressivity or poverty-effectiveness.

- Over time, we should not classify as "old" people over a given chronological age, as opposed to those with the same expected years from death or at least age relative to life expectancy. For example, Julia's use of per capita elderly spending with a constantly expanding definition of who is elderly, at least as measured by life expectancy, ignores one of the sources of growth in relative elderly spending—the increase in number of years of support as people live longer.

- When classifying "equals" for purposes of making judgments on horizontal equity or equal justice, standard public finance also indicates that ideally we should be measuring those with equal ability relative to need. For full-time labor force participants, income is not a bad approximation, but it generally works poorly when dealing with those who can decide whether or not to work. The average income of 45-year olds raising children is a better approximation of ability than is the average incomes of 62-year olds, many of whom decide to retire that year. Poverty level statistics suffer from the same problem.

Lifetime Packages of Elderly Benefits

Putting some real numbers on household benefits helps us understand better some of what is at stake.

The average couple retiring today is scheduled to get a package of Social Security and Medicare benefits equivalent to a retirement account worth about $900,000 at age of retirement. Add in Medicaid and some other potential benefits, and the number approaches $1 million.

This number might appear large, but consider that the average couple retiring at age 62 will get benefits for about 26 years. Skipping over the influence of health cost growth and discounting, 26 years at $40,000 a year comes close to $1 million in benefits. Under current law, the average income couple retiring in another 25 years would receive about $1.5 million in benefits. And, by the way, higher income groups, such as the people at this conference, as well as those who are healthy, get even higher expected benefits.

While I understand that under an individual equity principle or a benefit theory of taxation, one ought to get back what one pays to government, I believe we taxpayers have already gotten a return in the form of support for our parents, who, by the way, received a very generous extra benefit relative to the taxes they paid. We cannot then automatically assume that we are entitled to a market rate of return from our children.[4]

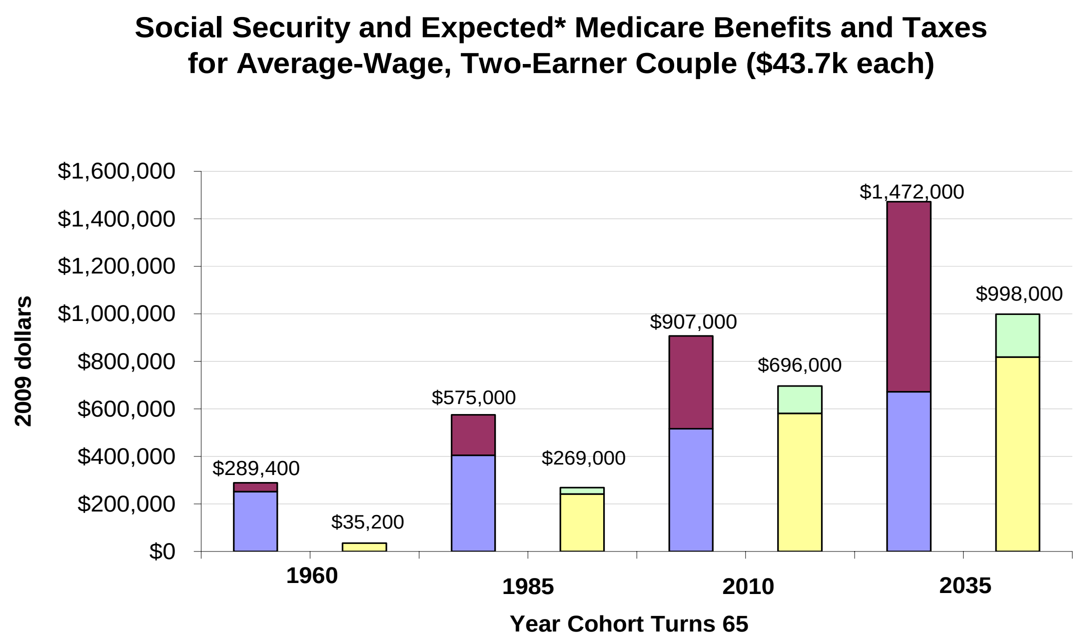
Even if one were to apply some "benefit theory" of taxation to the elderly transfer system, it is hard to believe that it would show the weird type of cross-generational pattern exhibited in the table below. Among other issues, counting Medicare benefits and taxes, there are still substantial transfers being made to most of those retiring today and for a considerable period of time in the future.

On the other side of the ledger, children are scheduled to get close to nothing in future expenditure growth. Many programs are scheduled to go into real decline, others only to keep up with inflation. For instance, the child credit isn't indexed for inflation, while the EITC is only indexed for inflation but not real growth in the economy. Most children's programs are discretionary in nature and generally decline in importance over time.

There is a long fiscal history here, but in simple form there were huge shifts from defense spending to domestic spending largely through four large postwar dividends: post World War II, post Korea, post Vietnam, and post Cold War. These shifts were achieved largely without increases in average tax rates, and almost all of the money (as a percent of GDP) essentially went to support retirement and health programs (mainly for retirees),

[4] In fact, while I believe that I am the first to compare both lifetime Social Security and Medicare benefits and taxes, and one of the first to compare lifetime Social Security benefits and taxes, I do not use terms like "money's worth." I make the comparisons to see if we find reasonable the redistributions that result.

while children got very modest sums (and even lost out a bit by some measures). As domestic spending levels out as a percent of national income, large growth in automatically growing programs will crimp children's programs, which fight for leftovers. Outside of rising interest on the debt, the growth in the elderly budget will absorb almost all the additional revenues of government, even with substantial increases in taxes. Julia appropriately asks if this is the world we want.



(Left bar for each year: Benefits; Right bar: Taxes)

Demographics Have Mattered and Do Matter—A Lot

Growth in relative spending on the elderly has been and will be driven by several factors: longer lives, lower birth rates, earlier retirement, and health cost growth, among others. In both budget debates and debates over the allocation of the budget toward the future elderly, some imply that our budget problems are driven merely by health care costs. Yet the first three do matter. Among other factors at play, demographics such as years of support in retirement affect output and incomes of the elderly and *revenues* to government—regardless of their effect on Social Security.

Each of these demographic issues, such as more years of retirement support, raises its own particular issues of fairness and efficiency as to how society adjusts to those changes, but I can find no standard of fairness or efficiency that implies that each source of additional cost should be shifted forward to future generations.

Two examples will suffice.

- If we live longer, should we be entitled to more years of health and retirement benefits than our predecessors? If the newly retired elderly are granted many more years of benefits than their predecessors, does that mean that future retired elderly are similarly entitled? More directly, does any standard of equity entitle what will soon be close to one-third of adults to retire for close to one-third of our adult lives now and even more in the future?

- If birth rates fall and lead to a substantial decline in workers supporting all programs, then was it wrong for the 1983 Social Security Commission to effectively lower after-tax replacement rates and reduce what are sometimes called "legacy costs?" To consider a more extreme case, we know that an adjustment must be made if the worker-to-retiree ratio drops from 4-to-1 to 0-to-1. Why would we not think that an adjustment was required if the ratio falls half-way there, as it has been doing—from 4-to-1 toward 2-to-1, or, more recently, by one third, from 3-to-1 toward 2-to-1?

Health Care

There is no doubt that health cost growth is a major source of the difference in the growth in spending on elderly versus children's programs. Julia poses the issue of relative growth in spending among groups partly as one of fairness, yet applying standards of equity across generations to health care presents a number of formidable problems. We can still ask the question as to what types of spending produces the highest return for society, although that by itself doesn't answer the equity question.

Consider all of the following:

- Suppose a new government-provided drug benefit costing trillions of dollars over time is adopted.

- Suppose surgeons cost $400,000 per year and pediatricians $150,000 and, for the most part, the elderly make use of the former and children the latter. Suppose in addition the ratio of expected surgeon-weeks of benefits relative to pediatrician-weeks rises from a ratio of 3-to-1 to 5-to-1.

- Suppose someone today comes up with a new procedure that extends our lives by, say, one month on average.

Under our current ways of operating, all of these shifts in well-being would initially be paid for not by those who gained but by younger families—those who bear most of the burden of raising children as well. But why? Under what principle of equity can those who get additional benefits demand that others bear the costs of those benefits? If Julia or Henry or I are getting extra years of life and more high quality life out of some new improvement or benefit or simply more spending because medical oligarchies are able to charge higher prices, what right do we have to demand that we bear none of the additional cost? That others in society should give automatic priority to paying for our gains over spending on children?

Summary

In sum, no two of us are going to allocate the budget in exactly the same way or grant equal weight to different principles. What we can agree upon is that budget classifications help us to consider the choices we are making and that there are ways to determine if we are applying principles consistently across programs and across time. My own conclusions are similar to Julia's: applying most principles—not just principles of fairness—to today's budget leads to the conclusion that it is increasingly a budget for a declining nation and that a portfolio shift is required to make it more oriented toward investment in children.