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Will Population Aging Squeeze Government Budgets? A Look at Japan and the United States

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Population aging is a global phenomenon, fueled by lower birth rates and longer life expectancy. In many countries, there is widespread concern about the costs of providing support to expanding elderly populations. But how much financial support will these growing elderly populations actually need? And who will pay for this support?

In a recent paper prepared for the US National Academy of Sciences, East-West Center researcher Andrew Mason and his colleague Ronald Lee from the University of California at Berkeley write that "in the most affluent countries, the elderly spend considerably more than any other age group." And in high-income countries around the world, they warn, "spending by the elderly is expected to rise steeply—from about 20 percent of the labor income of a country's entire population in 2017 to 42 percent in 2065."

This will become a problem if a large proportion of old-age spending is funded by government programs. Mason says: "If current age-specific benefit levels continue, public spending on old-age needs will grow rapidly. And if lower fertility rates persist, there will be few working-age tax payers to shoulder the burden."

To reduce the pressure on government budgets associated with population aging, Mason and Lee recommend policies to: 1) encourage older workers who are in good health to delay retirement; 2) help working-age adults accumulate assets they can rely on in old age; and 3) improve the job prospects of young people by providing education, training, and capital investment.

Mason and Lee's paper focuses on senior spending and support in the US, but a comparison with the situation in Japan offers a second example of the issues facing developed nations. In both countries, spending rises steadily throughout old age, but the rise is considerably steeper in the US—particularly beginning at about age 80—primarily due to the high costs of healthcare and long-term care.

Do these high levels of spending have adverse effects on government budgets? The answer depends on how expenses in old age are paid for, Mason and Lee write. Basically, the elderly can cover their expenses in four ways: (1) they may continue to work and earn an income; (2) they may acquire assets when they are young and live off asset income in old age; (3) they may rely on government programs; or (4) they may receive support from their families.

On average, labor income begins to decline in the United States when Americans reach their late fifties. "By about age 60, people are spending more than they earn," according to Mason and Lee. "But labor income is still important for older Americans, supporting 57 percent of spending at age 65 and 27 percent at age 70."

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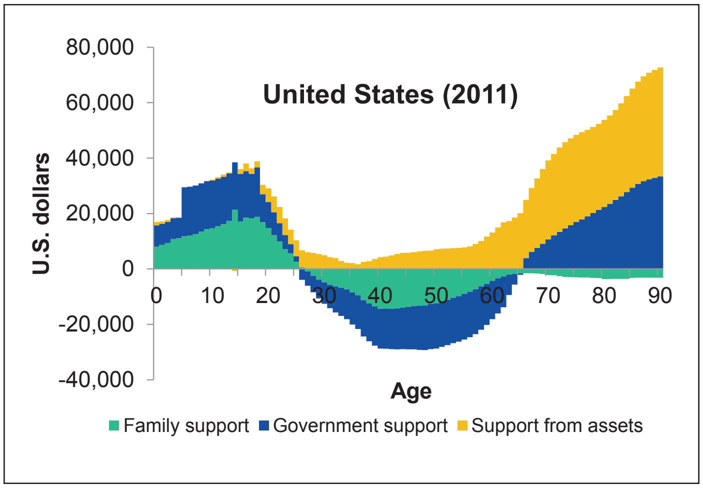

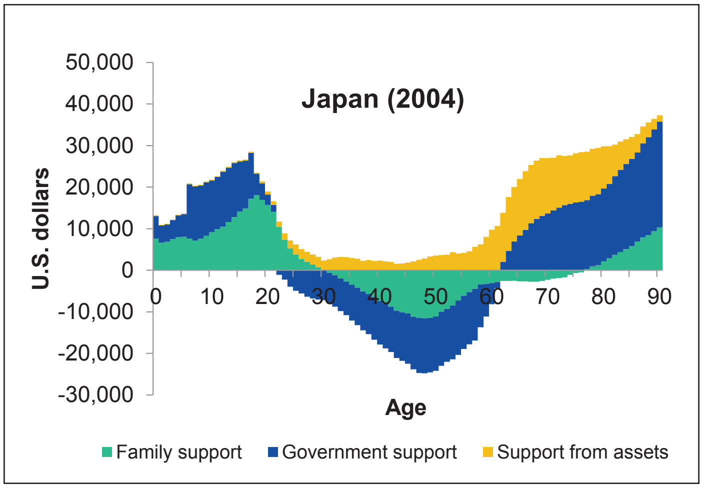

Apart from labor income, people at all ages may receive support from assets (areas in orange), government programs (areas in blue), and their families (areas in green). Assets provide the greatest source of support to the elderly in the US (left), while government programs provide more support in Japan (right). Negative values indicate that people are providing more support to their family or government (through taxes) than they are receiving.

People in Japan also begin spending more than they earn at about age 60. Labor income goes down much more steeply among older Japanese than among older Americans, however, indicating that Japanese are more likely than Americans to retire in their early 60s. As a result, labor income provides much less support to the elderly in Japan than in the US—only 32 percent of spending at age 65 and 16 percent at age 70.

To fill the gap between labor income and spending, older Americans rely heavily on income from assets (orange area in first graph). Such assets include saving and retirement accounts and homes and other property. Mason and Lee found that "beginning at about age 70, Americans draw on asset income to support just over one-half of their total consumption, and this use of asset income remains steady throughout old age."

Like Americans, at age 70 Japanese support about one-half of their consumption with income from assets (orange area in second graph). But in Japan support from assets goes down steeply with age, dropping to one-third of total consumption at age 80 and only 4 percent at age 90.

Public programs, funded by taxpayers (blue areas), provide the third source of support for the elderly. Up to age 65, seniors in the US pay more into programs such as Social Security and Medicare than they receive in benefits. After that, their reliance on government programs goes up steadily with age—from an average of 19 percent of total spending at age 70 to 39 percent at age 80 and 45 percent at age 90. "These benefits are considerable," say Mason and Lee, "but they still do not equal spending funded out of assets."

Elderly Japanese, on average, are much more dependent on government programs than the elderly in the US. In Japan, public programs support 55 percent of spending at age 70, 59 percent at age 80, and two-thirds of all spending—68 percent—at age 90.

Looking at family support, older people in most wealthy countries actually give more to their adult children than they receive. Mason and Lee found that, "even at age 90, Americans give about $3,000 more per year to their children than their children give to them (green area in first graph)." It's important to remember, however, that many of the elderly receive personal care from their children and other family members, and this is not included in measures of monetary support.

East Asia has a strong tradition of family support for the elderly, but even here the pattern is changing. Elderly Japanese give more to their children than they receive through most of their seventies. Then support from families goes up steadily, covering just over one-fourth of total spending at age 90.

One source of optimism is that improvements in health could slow down healthcare spending and allow people to work longer. Mason and Lee suggest that "straightforward policies—such as raising or eliminating mandatory retirement ages—could be effective." They add that "more capital investment plus better education and training could make workers more productive, partially offsetting the relative decline in the size of the workforce."