Soaring Numbers of Elderly Reshaping U.S. Economy

In the next few decades, the nation will experience dramatic demographic change as the ranks of the old grow faster than the rest of the population.

These changes will bring fiscal challenges and will affect the nation's labor supply and demand for products and services.

The graying of the population is expected to be a significant driver of U.S. government spending over the next quarter-century, the Congressional Budget Office has projected, because older people tend to depend heavily on entitlements such as Social Security; Medicare, the national insurance program for those 65 and older; and needs-based programs such as Medicaid and Supplemental Social Security Income.

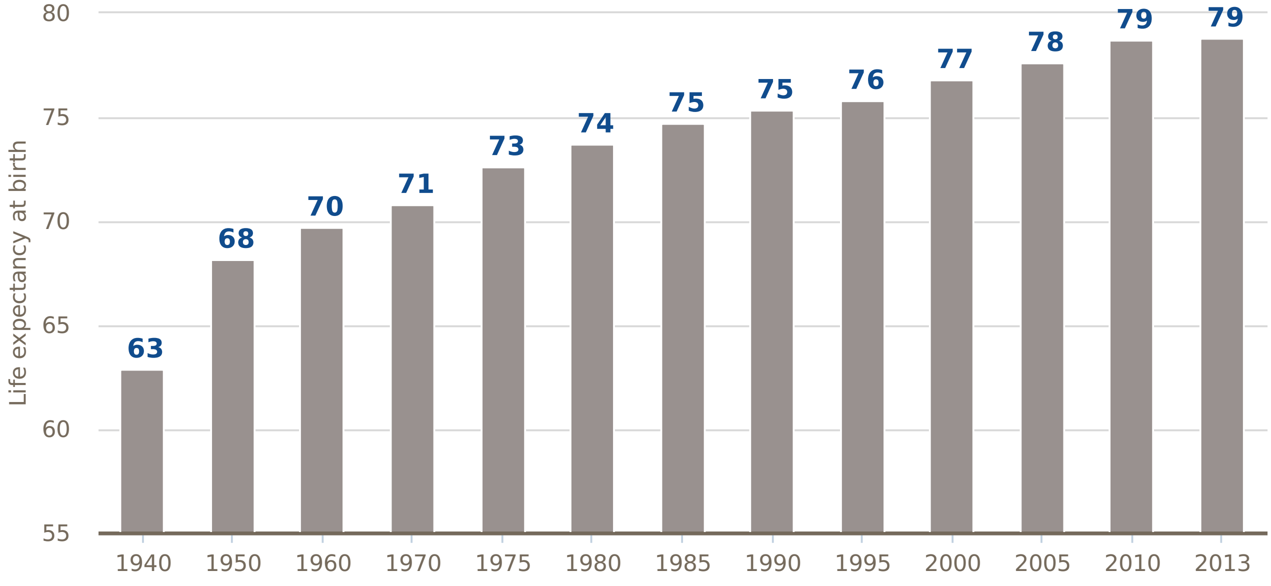
Living to 85 and beyond

People are living longer, thanks to medical advances and a public focus on healthy lifestyles. The average baby born in the United States in 2013 can expect to live 79 years, which is 25 years longer than an ancestor born in 1920 and 16 years longer than someone born in 1940, according to the Centers for Disease Control–National Center for Health Statistics (NCHS; see chart 1).

Another demographic trend: women are having fewer babies than decades ago. In recent years, the U.S. fertility rate reached record lows, falling about 1 percent in 2013 to 62.5 births per 1,000 women aged 15 to 44, NCHS data show. Teen births have also dropped to historic lows. The U.S. Census Bureau projects that fertility rates will continue to drop and the pace of immigration will decline modestly. (See chart 2.)

These trends will slow the nation's overall population growth just as the youngest baby boomers approach retirement. The

Chart 1
Americans are living longer



Sources: CDC–National Center for Health Statistics, University of California–Berkeley

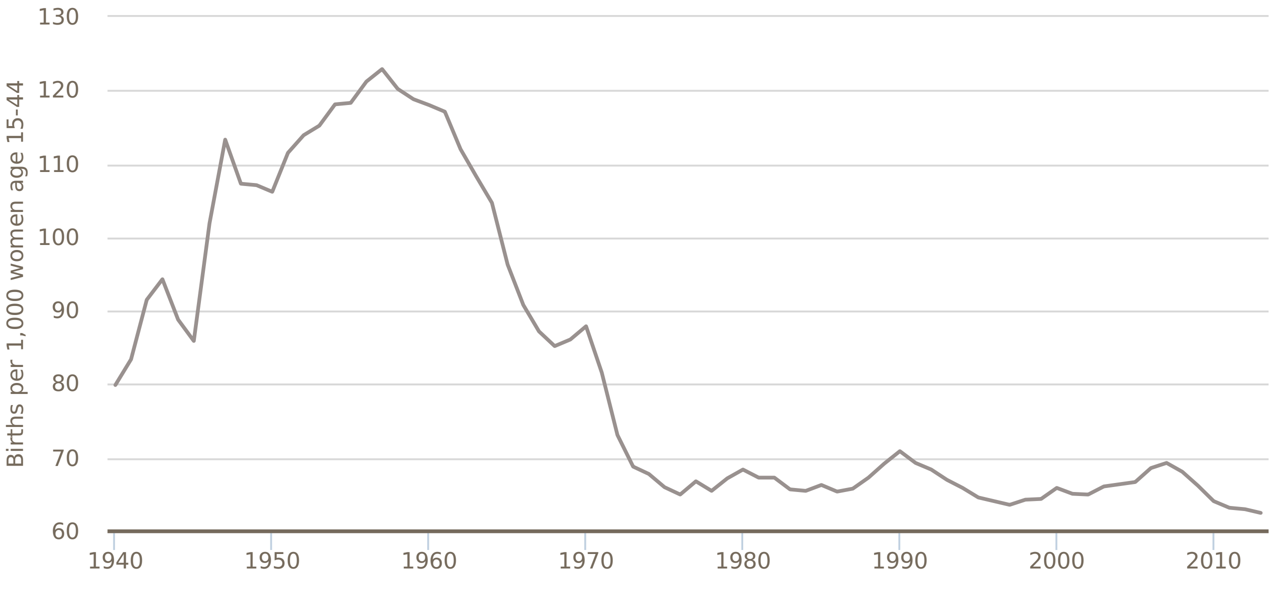
U.S. civilian noninstitutional population—that is, those people 16 years old and older who are neither in an institution nor on active duty in the armed services—is projected to rise 0.8 percent between 2014 and 2024, down from 1 percent growth in the previous 10-year period, according to the U.S. Census Bureau.

These two factors in conjunction with the aging of the baby boomers imply that the share of Americans 65 and older will rise from about 15 percent of the population today, or about 48 million people, to 21 percent, or 74 million, by 2030, the year the youngest baby boomers turn 65, according to U.S. Census Bureau projections. By 2050, that number is expected to nearly double to 88 million people, or 22 percent of the total U.S. populace. (See chart 3.)

The oldest of the old, those 85 and over, will account for a significant portion of the overall growth in the mature public. By the year 2050, adults at least 85 years old will account for 5 percent of the U.S. population, more than double their current 2 percent share, as their numbers triple to 18.9 million from 6.3 million now.

As the number of older people climbs, the proportion of working-age residents in the United States will shrink. Those 18 to 64 years old currently constitute 62 percent of the total population, but their share will drop to 58 percent by 2030 and 56.7 percent by 2060, Census figures show.

Chart 2
Repercussions of baby boom not nearly over



Source: CDC–National Center for Health Statistics, 2015

Shrinking labor market clouds future

The consequence of declining births and longer life expectancy is that in the future, proportionally fewer people of prime employment age will be around to pay the taxes that help fund Medicare, Social Security, and other government programs that support older people and children. (That goes also for critical national needs such as defense, security, border control, and education.)

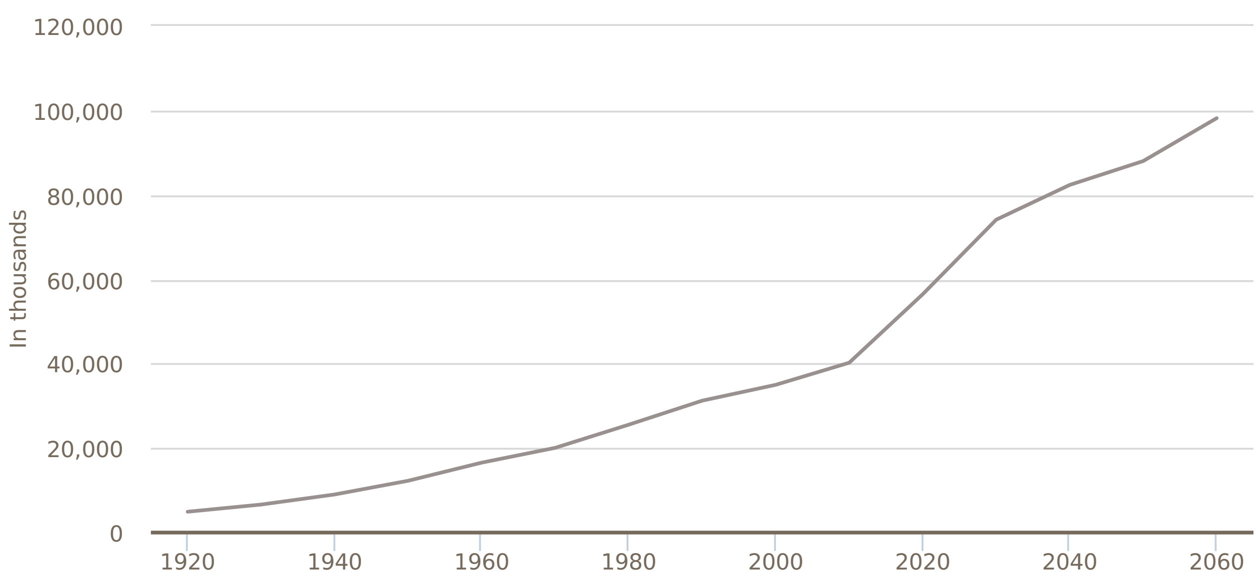
By 2030, there will be 2.86 people of working age (18 to 64 years old) for each U.S. citizen over 65. That compares with 5 people per older person in 2000 and 9.09 people in 1940. The decreased ranks of the working-age population and the higher costs of funding entitlements for retirees threaten to depress economic activity and slow economic growth.

These population changes are set to occur against the backdrop of an economy that has not fully recovered from the Great Recession, which left many U.S. households worse off financially. As some baby boomers look to their golden years, several million Americans have seen the value of their homes, their biggest source of wealth, decline. (Some home values have recovered and increased.) Skittishness about world markets, low oil prices, and the specter of slower growth in China have raised market jitters worldwide and depressed the value of stock equities that help many build assets to sustain them through retirement.

The emergence of an aging population is likely to have profound economic effects that may not be readily apparent. People of working age largely contribute more support and resources to society than they receive, while the very young and old generally consume more than they produce. Much of the consumption of older people is funded by the government through programs such as Social Security. As declining births reduce the supply of the nation's labor market producers, government's ability to support older people will become strained. The imbalance of consumers and producers is already spurring debate about difficult policy choices among legislators.

A 2015 report from the U.S. Bureau of Labor Statistics forecasted average annual growth in gross domestic product of 2.2 percent over the next decade, flat with the levels from 2010 through 2014, but slowing from 3 percent annually between 1960 and 2007. The agency cited slowing growth in the labor supply, which is mainly the result of aging.

Chart 3
Americans 65 and older



Source: U.S. Census Bureau, Population Division, 2015

Health a critical factor

Neil Mehta, a demographer and assistant professor of global health at Emory University in Atlanta, says the critical issue is not how many more older people there will be in the coming decades. "A lot of the ramifications that aging will have for society are going to be dependent on health," he said.

He pointed out that while chronic disease is always a risk with aging, the health of older people has generally improved in the past 20 to 30 years. And while people reaching the age of traditional retirement may not want to work 9 to 5, they may desire and need to be active in the labor market, he added.

With this in mind, Mehta said policies that allow alternative workplace arrangements, such as working at home or opportunities to work part-time, are the kinds of solutions that should be discussed to help mitigate the perceived adverse macroeconomic effects of an aging population.

"There may be creative ways to tap into the potential for older people to contribute to the economy," Mehta said. (See the sidebar "Challenges of Aging Are Not Hopeless.")

The next section, "Fiscal Math Is Daunting," offers more details about the hard fiscal reality the United States is facing because of its aging population, especially when it comes to Social Security and Medicare.

Section 3, "Profound Changes in Store for Labor Market," to be released in April, looks at how baby boomers are affecting the U.S. labor force participation rate. Finally, section 4, "Is an Older Economy a Weaker Economy?" explores the spending and saving habits of older people, including expenditures on health care and housing. Section 4 will be released in late May.

The critical issue is not how many more older people there will be in the coming decades.

Challenges of Aging Are Not Hopeless

While the aging of the population will produce economic and fiscal challenges, the outlook is not uniformly grim. There are reasons for optimism on several fronts, from the labor market to health care costs to the general dynamism of the U.S. economy.

For starters, the nature of retirement as we know it appears to be changing in ways that could lighten the burden on programs like Medicare and Social Security and benefit the macroeconomy. After steadily falling for decades, the average age of retirement in the United States began climbing in the late 1990s.

Nearly three times as many people age 65 and older are employed now as were employed in the late 1980s, according to the U.S. Bureau of Labor Statistics (BLS; see chart 4). The labor force participation rate among older Americans is likely to keep rising, even as the rate for the overall population declines (see chart 5). For example, the participation rate for those 75 and older will reach 10.6 percent in 2024, roughly double the rate in 1994, according to BLS projections.

Why are people retiring later? The answers are not certain, according to Atlanta Fed economists Toni Braun and Karen Kopecky.

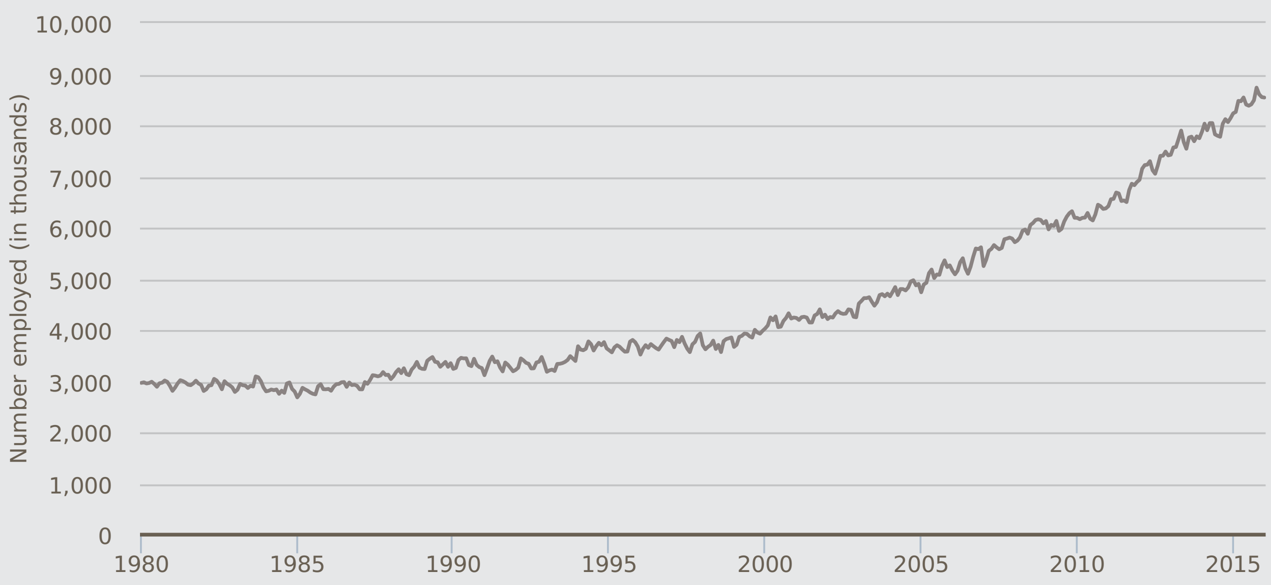
"It's not necessarily clear that these higher labor force participation rates later in life reflect that people are feeling poor and need to work longer," Braun says. "It could be that technology is changing in ways such that it's easier for them to transition into retirement, as opposed to abruptly stopping work entirely. That may not be a bad thing."

Smooth labor supply, not abrupt changes, is optimal

Basic economic models say a gradual transition into retirement is optimal for the macroeconomy, and probably for most individuals, too, Kopecky explains.

Even though older people are likely to continue working later in life, overall labor force growth will slow. The BLS projects that the labor force participation rate will continue to decline through 2024. The decline, coupled with comparatively slow

Chart 4
Labor force statistics from the Current Population Survey



Source: U.S. Bureau of Labor Statistics

growth in the working-age population, will produce labor force growth of just 0.5 percent a year on average through 2040, according to the Congressional Budget Office. That's less than a third of the average annual rate of labor force growth, 1.7 percent, between 1970 and 2007.

Slower labor force growth could pose a challenge to economic growth, says Julie Hotchkiss, an Atlanta Fed research economist and senior policy adviser. Then again, a slower-growing labor force is not necessarily a recipe for lower productivity and stunted economic growth.

It is true that as baby boomers enter old age, they become net consumers and not net producers. On the other hand, some older people amass lots of wealth by saving for many years. So the economy is transitioning from one with an age structure favorable to production—with a bigger share of working-age people—to one more favorable to deepening capital for investment, points out Gretchen Donehower, a demographer at the University of California-Berkeley's Center on the Economics and Demography of Aging.

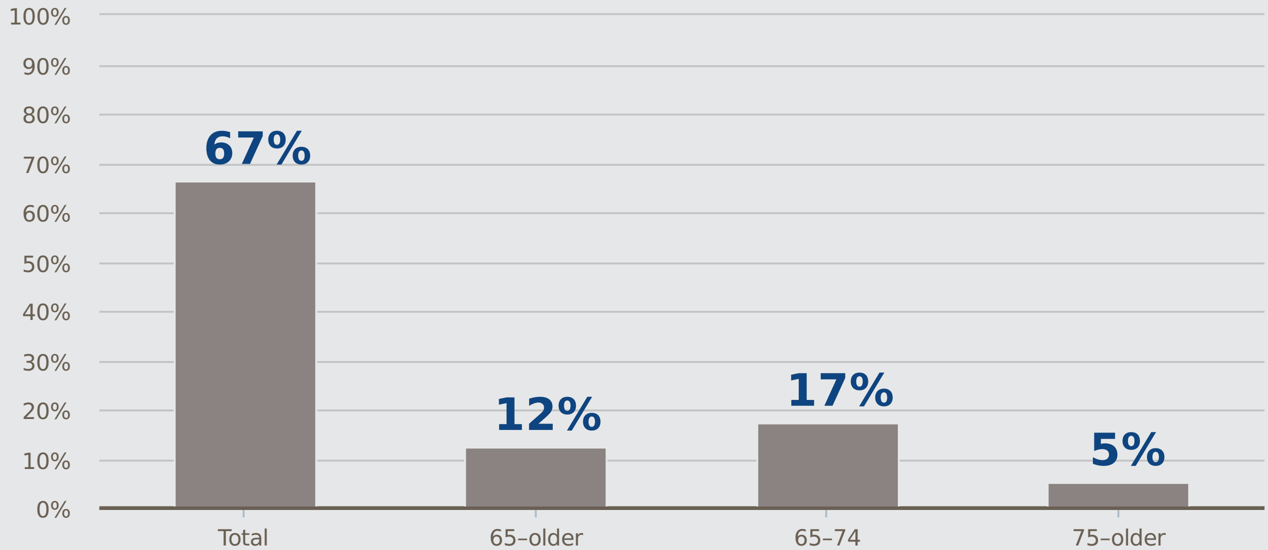
"If the amount of available labor goes down, you can perhaps compensate by giving each worker more capital to make them more productive," Donehower says. "This would counteract the population aging panic."

The more we save for retirement, the better for us and the macroeconomy

Of course, a surge of investment in human and physical capital won't happen by itself. Various policies and incentives would be required to channel wealth toward capital investment. And it's not certain this will happen. Braun does not subscribe to the theory that wealth accumulated by elderly people will lead to heavy capital investment and thus more productive, if fewer, workers.

He points to research suggesting that while elderly people save throughout their lives, they tend to spend their wealth in retirement. Moreover, shocks during old age—a spouse's death, a major health problem—tend to quickly wipe out wealth, according to research by

Chart 5
Labor force participation rates by age group: 1994



* projected
Source: U.S. Bureau of Labor Statistics, December 2015

economist James Poterba of the Massachusetts Institute of Technology.

Clearly, the more that all Americans save, the less difficult will be the demographic shift.

Pegging how much the elderly have saved is no simple matter, though. Many are well off. A 2012 study by Poterba, Steven Venti of Dartmouth College, and David Wise of Harvard University found that between 1993 and 2008, the median wealth of married senior-citizen couples, about a year before they died, exceeded $600,000. Yet they also found that 46 percent of the elderly in the United States had less than $10,000 in financial assets when they died.

The economist Ronald Lee of the UC-Berkeley Center on the Economics and Demography of Aging took wealth into account in constructing an alternative to the standard old-age support ratio. In a paper presented at the Federal Reserve Bank of Kansas City's 2014 Jackson Hole Economic Policy Symposium, Lee noted that the support ratio ignores capital and reflects only labor income in relation to consumption.

He concluded that "the impact of population aging is cut by three-fourths using the general support ratio," his new formulation. Using his general support ratio, he calculated that the growth of output per hypothetical consumer declines by 0.06 percent a year from 2010 to 2050, instead of 0.26 percent annually under the ordinary old-age dependency, or support, ratio. The standard support ratio refers to the ratio of elderly people to working-age people.

Another hopeful sign in the battle against the demographic wave: the growth in health care spending has slowed in recent years. Part of the story is that older people today generally are healthier than older people of earlier generations, thus requiring less expensive care, Donehower says. The percentage of people in nursing homes is declining as older people are generally healthier and as programs encourage people to avoid the very costly care nursing homes provide.

Population aging will have many and diverse economic impacts. But that alone is no cause to despair.

"The bottom line is that the nation has many good options for responding to population aging," notes *Aging and the Macroeconomy: Long-Term Implications of an Older Population*, a 2012 report compiled by the National Research Council for the U.S. Congress. "On the whole, America is strong and healthy enough to pay for increased years of consumption through increased years of work, if we so choose. Alternatively, we will be healthy enough to enjoy additional active years of retirement leisure if that is our decision, individually or collectively."

There are reasons for optimism on several fronts, from the labor market to health care costs to the general dynamism of the U.S. economy.