Aging of the Elderly: Can an Intragenerational Funding Approach Help Society Cope with Improved Longevity?

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Abstract

The persistent gains in longevity at older ages: "aging of the elderly," along with the imminent retirement of large baby-boom cohorts, imply that new ways will be needed to encourage the elderly themselves to fund more of the costs associated with old age. Based on current trends, the costs of pensions and health care for the retired are likely to outstrip the willingness and capacity of the working population to pay. This cost burden, most obvious in pay-as-you-go programs for pensions and nationally funded health care systems, is not necessarily alleviated by pre-funding or other financial maneuvers. Indeed, there are few economically sound ways to reduce the burden on the working population. Under conventional arrangements, the costs fall largely on the working population through either higher taxes or direct familial support. Promoting individual responsibility by encouraging personal saving can only go so far, and in any case is not likely to have much impact on the accumulated assets of many in the baby-boom cohorts.

In many countries, apart from a good deal of rhetoric about the need to increase private saving, there has been little discussion to date about the role of social insurance. This perhaps reflects the conventional thinking popular in countries like the United States and New Zealand that the market itself will solve the problems without a need for rethinking the public/private interface issues. While it is true that the 21st century brings improved average living standards, at the same time it brings greater personal risk, at least for the many who are only modestly well-off rather than wealthy. Currently, in countries like the United States and New Zealand, social security and means-tested social assistance programs for long-term care protect the living standards of the poorest. The wealthiest have always been able to look after themselves, but middle-income groups face under-appreciated risks, such as outliving capital or needing long-term care. This is becoming even more critical as private pensions become less common and user pay elements increase in health care financing. At age 65, individuals have a 50 percent chance of living longer than the average life expectancy, and the spread of mortality around the average means that it is not an uncommon experience to live up to twice as long as the average. For those who require expensive health care, current practice of user pays can mean that individual estates are quickly depleted, imposing costs on some of the working-age population whose inheritances diminish or disappear. The challenges of funding retirement in the 21st century will require new thinking about these insurance issues by the actuarial profession. It is also important that suggested solutions are carefully designed to minimize work disincentives because working longer will be a key way in which the elderly themselves contribute to the costs of their aging, Using the United States and New Zealand as illustrations, this paper explores how an intragenerational funding approach might spread the risks from those older persons who live longer to those who do not live so long and from those who are healthier (or less dependent) to those who are less healthy (or more dependent).

As society continues to age, a greater share of society's resources has to be devoted to older people. This is inescapable. Intragenerational risk sharing has the potential to lessen concerns about intergenerational conflicts since it will be made clear that the elderly as a group are spreading the costs among themselves. The suggested intragenerational funding approach is intended as a supplement to, not a replacement of, existing programs that use the intergenerational funding approach.