REMAPPING DEBATE
Asking "Why" and "Why Not"

Freeing up an enormous nest egg

Original Reporting | By David Noriega | Aging, Role of government, Social Security

October 16, 2013 — A news analysis in The New York Times this month neatly summed up the conventional wisdom that drives the proposals and rhetoric of a broad political spectrum from Tea Party Republicans to Democratic centrists, wins grudging acceptance even among some elements of the centerleft, and is constantly reinforced in the media: “the United States must confront the rising costs of the benefit programs, especially Medicare and Medicaid but also Social Security.”

But the “unsustainability” argument — presented by the reporter as an unchallengeable fact — ignores completely another perspective: that a focus on reducing financial insecurity instead of reducing benefits would likely yield not only important psychological benefits to millions of senior citizens but also important gains for both national and local economies in the medium and short term.

> Savings for old-age health costs are estimated to account for a full 11 percent of the country’s private wealth.

For example, a growing body of economic research shows that the risk of high medical and long-term care expenses makes retirees in the U.S. uncommonly unwilling to spend such retirement savings as they have. With greater financial security, seniors would be less likely to deprive themselves of enjoyable activities or to defer needed medical care.

Moreover, if retirees were freed from their concerns about health-related expenses, they would likely spend far more of what turns out to be, in the aggregate, trillions of dollars in untapped capital. This change in habit would represent a great economic boon to the U.S. and to the localities where retirees live.

The implications work both ways: if the safety net is restricted further, seniors will be even more compelled to hang on to their money, and the communities that rely on their spending will suffer as a result.

Yet these considerations and others like them are absent when there is talk in Washington about the need to be “realistic.” The AARP Public Policy Institute, for instance, recently released a report tracking the effects of Social Security spending throughout the nation, finding that every dollar generates two in economic output for an added total of $1.4 trillion. But Gary Koenig, the Institute study’s principal author, said it’s difficult to get a word in edgewise in a budget-obsessed debate.

"It seems to me that we're in a world right now where spending is characterized as bad, and high taxes are characterized as bad, and both are characterized as disastrous to the economy," Koenig said. "And that leads you to one conclusion, which is that we need to achieve fiscal balance in our budget only through spending cuts."

"It's a very narrow, limited focus," Koenig added. "I think it misses the bigger picture."

You Can't Take it With You

American retirees are notoriously thrifty. Data from the University of Michigan's Health and Retirement Study on median household net worth illustrate the point. As of 2006, heads of household aged 90 had a median household net worth of about $75,000. This is higher, as a proportion of net worth at age 65, than in most other industrialized countries. Among economists who study patterns of saving and spending across lifetimes, this has always been something of a puzzle. If, as the saying goes, there are no pockets in a shroud, then why do the elderly hold on to their money instead of spending it?

The desire to leave an inheritance is one explanation, though it has been found to be a relatively minor concern among households that aren't very wealthy. Instead, a number of recent studies have found that a more significant factor is the potential of having to pay large sums out of pocket for medical and long-term care, the fear of which compels retirees to leave their nest eggs undisturbed.

In a working paper funded by the Retirement Research Consortium, Irina A. Telyukova and Makoto Nakajima, economists at the University of California, San Diego and the Federal Reserve Bank of Philadelphia, respectively, compared the spending rates of American retirees to those of several other countries, mostly European. Focusing on relatively liquid financial wealth (rather than housing assets), they found that, consistently, the countries with higher retiree spending rates were those where public insurance programs reduced or eliminated the risk of health-related expenses.

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Telyukova and Nakajima zeroed in on a comparison between the U.S. and Sweden in part because the retirement picture in the two countries is similar: ratios of savings to income upon retirement, homeownership rates, and so forth. They key difference is in social programs. While Swedish retirees, regardless of income, have free access to medical and long-term care, Americans have only limited medical insurance through Medicare and, except for Medicaid assistance to the very poor, no public coverage of long-term care.

Telyukova and Nakajima found that, by the time they're pushing 90, American households have spent down only about one third of their financial assets, while Swedes have spent nearly three quarters. They found, moreover, that the majority of this difference — around 70 percent — can be accounted for by the disparities in the countries' healthcare safety nets.

As with all research drawn from complex economic models, these findings have their caveats. To make the U.S.Sweden comparison, Telyukova and Nakajima had to set aside other variables that could potentially explain the variations in spending habits. There could be cultural differences regarding attitudes towards money and aging, for instance, or differing preferences about leaving inheritances. As such, Telyukova cautioned against reaching the conclusion that, in the hypothetical presence of universal medical and long-term care, American retirees would behave exactly as Swedes do.

Nevertheless, Telyukova and several other economists interviewed by Remapping Debate agreed that the impact of health expenses on spending by the elderly is real and significant — and that it ought to form a part of policy discussions.

"Policies that affect the amount of medical expenditures that the elderly are exposed to will have effects on their savings," said John Bailey Jones, an economist at the State University of New York at Albany who has contributed to research finding that health expenses go most of the way toward explaining why seniors hold on to their money. In other words, it is likely that American retirees would spend significantly more of their money if they didn't have to worry about saving it for medical and long-term care — and this could have potentially large consequences for the American economy at large.

"If there's a raindrop anywhere in 100 miles they won't go out, if it snows they won't go out — because they're terrified that if they fall, that's the beginning of the end." — Philip Mushkin

"Older people would spend a lot more of their money instead of saving it," said Joelle SaadLessler, an economist at The New School. "And that would stimulate the economy."

Fear of Falling

Setting aside for a moment the strictly economic benefits of public programs for medical and long-term care, there are profound questions about the human costs imposed when older people are plagued with the fear of not having enough put aside to pay for medical care if they fall ill, or, more broadly, the fear of outliving one's savings. The picture is a depressing one: a dreary life of endless, penny-pinching preparation for a catastrophe that may or may not come.

Those whose work brings them into contact with the elderly — and the fears they commonly express — say the typical American retiree's anxiety over spending is very real. Philip Muskin, chief of Consultation-Liaison Psychiatry at the Columbia University Medical Center, said he encounters it often. Muskin doesn't call this fear a "disorder" (because, in most cases, the fear is perfectly rational), but, he told Remapping Debate, "It's a palpable anxiety."

"And it does limit people," Muskin added. "If you've lived into your 70s and you're reasonably healthy, you really shouldn't be worrying about anything. You should be having a good time. You should be pursuing those things that perhaps hard work didn't give you a chance to pursue." But fear makes the elderly anything but carefree.

“One way you see it in elderly people is that they become incredibly phobic of falling,” Muskin said. Central to this fear, Muskin said, is that medical or nursing home care will drain any remaining assets. “They won’t go out, or they’ll go out in very limited ways. If there’s a raindrop anywhere in 100 miles they won’t go out, if it snows they won’t go out — because they’re terrified that if they fall, that’s the beginning of the end.”

Julia Sear, a clinical social worker in New York who has worked in gerontology for 20 years, told of a 91-year-old client with $300,000 in savings that she is terrified to touch. The client’s husband is dead, and she has no children to inherit her wealth. Nevertheless, “her anxiety level has gone up around this money, because she thinks, ‘There’s nobody who’s going to take care of me,’” Sear said.

Asked how her client — a retired fashion designer — might live differently if she didn’t worry about having to spend her money on medical care or a nursing home, Sear was quick to respond. “I think she would have a happy next month or 10 years,” she said. “She would take that incredible energy and interest in life and do what she used to do, which was create gorgeous clothes. Or she would go to the Museum of Modern Art, where she’s been a member for 60 years, and she would go watch foreign films. Now she sits with a giant book of providers making sure her ophthalmologist is in-network.”

Failing to make long-term care affordable

The unavailability of affordable long-term care insurance — which is not covered by Medicare — is the most important risk factor in causing seniors not to spend, according to the economists who have studied the matter. It is even more important than medical expenses, they say, because these are usually covered at least partly by insurance or government benefits.

Private long-term care insurance is a small and capricious market, said Joe Caldwell, director of Long-Term Services and Supports Policy for the National Council on Aging: only about 10 percent of Americans over 50 are currently insured, and their plans are prohibitively expensive for all but the wealthy and subject to sharp and sudden rises in premiums. Medicaid provides relief only insofar as it keeps those already poor from total destitution, stepping in to provide long-term care once a senior has less than about $2,000 in assets. With nursing home costs averaging around $70,000 a year, the expense can “wipe out most people’s assets within a year or two,” Caldwell said. “It’s not pretty.”

The Community Living Assistance Services and Supports (CLASS) Act, originally part of Obama’s health reform plan, would have created a voluntary public long-term care insurance program. After it was enacted, however, the Obama administration (via Health and Human Services) came to the conclusion that it was financially untenable, and that portion of the Affordable Care Act was defunded and later formally repealed by congress. But the CLASS act, Caldwell said, actually had several workable strategies to become financially feasible, many developed by Health and Human Services itself — strategies that Caldwell believes were ignored in the overall drive to compromise on the extent of the Affordable Care Act.

A congressionally mandated commission recently released a report describing the dire state of long-term care in the United States but, Caldwell said, offered no detailed financing solutions. “The biggest issue is that we as a country haven’t figured out a way to finance long-term care… especially one that doesn’t force you to become poor,” Caldwell said. “Most other industrialized countries have realized this is an issue and done *something*.”

Sear noted, too, that this client is markedly better off than most. Those with significantly fewer savings feel, rather than the deprivation of foregone enjoyment, a precarious daily life of cut corners — skipped meals, over-the-counter medications that inadequately replace prescriptions, and so on.

“Psychologically it’s a very real thing that there is no real safety net, and that the safety net we do have is so tenuous, so complicated and arcane,” Sear said. “People are really scared to spend their money. Because you never know what’s going to happen.”

Investments with big dividends

Beyond enhancing the basic quality of life of America’s seniors, expanding medical and long-term care insurance would almost certainly yield broad economic benefits. How powerful might the impact be? The first step towards knowing is to look at the amount of capital involved — the amount of money that would be potentially freed up for spending in the absence of health expense risks. Karen Kopecky and Tatyana Koreshkova, economists at the Federal Reserve Bank of Atlanta and Concordia University in Montreal, respectively, estimate that savings in the U.S. for old-age health costs (including both medical and long-term care expenses) account for a full 11 percent of the country’s private wealth. This, they say, is equivalent to “the entire stock of industrial equipment in the U.S.”

> The current focus on achieving fiscal balance only through budget cuts, said Gary Koenig, is “a very narrow, limited focus. I think it misses the bigger picture.”

This means that a vast pool of wealth — estimated to be in the range of $4 trillion — that is currently constricted by fears of high health costs would likely be freed to circulate in the economy. To understand the potential impact, it is useful to look at local economies that rely on large populations of retirees. Communities around the country have long bent over backwards to attract affluent retirees — those whose assets are enough that they can spend them down without worrying too much about health expenses.

According to Mark Fagan, a professor of social work at Jacksonville State University in Alabama who has studied the economic impact of retirees for more than 20 years, communities that manage to attract affluent retirees in large numbers benefit enormously from their spending. “That becomes one of their main economic engines,” he said.

Retirees spend money “on real estate, on the financial industry, they go out and eat, they buy toys for their grandkids, they play golf… That spending creates the demand for those services,” Fagan said. “Every time [retirees’] money gets spent, it has an economic impact.”

Fagan cited the example of Sequim, Washington, a small town he studied around 1990 whose retiree population had grown dramatically in the preceding two decades. Fagan analyzed the change over time in the number and kinds of businesses in the town: “I saw the number of restaurants increase dramatically, real estate agencies increase dramatically” — and so forth, he said.

The impact of spending by retirees doesn't stop with the businesses that benefit: there is a cascade effect. The money that retirees spend gets returned in part to the local, state, and federal government in the form of taxes.

Advocates and others interviewed by Remapping Debate said that those seeking to cut benefits were looking at the costs of social programs in isolation from their economic benefit. "Right now, about 70 percent of the economy comes from consumers spending money. And when you put money into the pockets of senior citizens," said Warren Gunnel, a senior policy advisor for Senator Bernie Sanders of Vermont, "they're going to put more money into the economy."

The cost of cutting back

What would happen, though, if the amount of money spent by the government on seniors — either direct payments like Social Security or indirect ones like Medicare — were to decrease? The amount of money seniors can and do spend on non–health-related goods and services would decrease along with them. "What you're going to have if you take those resources back from spending on restaurants, on consumer goods, automobiles, whatever — then the economy will respond to that," Fagan said. "You'll have some restaurants go down. You'll have some stores go out of business."

Promoting a different kind of fiscal cliff?

During last year's fiscal cliff fiasco, President Obama floated the idea of a so-called chained Consumer Price Index, ostensibly as a means to measure more accurately how much the costs of retirees rise each year. The idea has come up repeatedly since then. The proposal would result in lowering the cost-of-living adjustments seniors receive each year. Social Security Works, a coalition of groups opposing cuts, argues that chained CPI, among other things, understates the role of medical costs in the budget of retirees and calculates that the average retiree would lose $14,000 between age 65 and 85.

The proposal, however, has been backed by several think tanks on the center and center-left, including Third Way, the Center for American Progress and the Bipartisan Policy Center. Some of these think tanks also support other ways of scaling down senior benefit programs, like expanding means-testing for Medicare, often on the premise that such measures would affect only wealthier seniors. Remapping Debate contacted these three think tanks (along with No Labels, a Michael Bloomberg–funded "non-partisan" group) to discuss the broader economic and social consequences of such plans. All either declined to comment or did not respond to requests.

The idea that benefit programs are the prime culprit in a reckless drive toward unsustainability is the bedrock of so-called bipartisanship. It is central to the philosophy of the Simpson-Bowles commission and its advocacy offshoot, Moment of Truth Project, which wrote in an August letter to the House Ways and Means Social Security subcommittee: "We strongly believe in the importance of bringing long-term entitlement spending under control." The premise also has an adherent in President Obama. At a press conference shortly before the president introduced a budget proposal in April, for example, he said (citing Medicare specifically) that he was "prepared to take on the problem where it exists: on entitlements."

Fagan argued that this would be part of a larger restructuring that, he said, is not all bad: a lot of this money would be channeled towards private health care spending, which still supports job creation and economic activity in that industry. Nevertheless, if the overall dollars flowing into an area — from both government and private spending — goes down, industries catering to demands for goods and services other than critical health care needs will suffer.

The question of the consequences of cutbacks was explored by the AARP Public Policy Institute's study of Social Security's economic benefits. The study warns that the positive economic impacts of retiree spending (like those described by Fagan) would be jeopardized by a benefits-cutting policy. This approach "ignores the reality" of what failing to bolster Social Security's finances would mean. If cuts projected to be required in 2033 in the absence of congressional action were to occur now, the study says, that could "cost the U.S. economy about 2.3 million jobs, $349 billion in economic output, about $194 billion in GDP, and about $93 billion in employee compensation."

Joe Caldwell, director of Long-Term Services and Supports Policy for the National Council on Aging, acknowledged that the austerity-minded political environment has forced organizations like his to adopt defensive postures, limited to protecting existing benefits rather than proposing ways to expand them. Koenig, of AARP, agreed, citing the chained CPI proposal for Social Security as a prime example of the ways in which the discussion in Washington is fundamentally skewed.

"The reason we're talking about the chained CPI is because the whole conversation is about budgets," Koenig said. "If we were talking instead about retirement security… we would be having a completely different conversation."

This content originally appeared at http://www.remappingdebate.org/node/2078