**August 28, 2004**

# Warning Anew About Retiree Expectations

**By EDMUND L. ANDREWS**

JACKSON HOLE, Wyo., Aug. 27 - The chairman of the Federal Reserve Board, Alan Greenspan, warned on Friday that the federal government might have to scale back promises to the elderly in programs like Social Security and Medicare.

"As a nation, we owe it to our retirees to promise only the benefits that can be delivered," Mr. Greenspan told a conference here sponsored by the Federal Reserve Bank of Kansas City.

"If we have promised more than our economy has the ability to deliver to retirees without unduly diminishing real income gains of workers, as I fear we may have, we must recalibrate our programs," he said.

Mr. Greenspan has expressed similar views many times in the past, but he went further on Friday by warning political leaders that they cannot count on continued rapid rises in productivity and faster economic growth to solve the problems ahead.

Economists have warned for years that retirement and health care costs will soar as the baby boom generation reaches retirement age and as the number of workers shrinks as a share of total population.

Mr. Greenspan's message was almost equally uncomfortable for Democrats as Republicans.

By implicitly calling for reductions in future benefits to the elderly, Mr. Greenspan attacked a basic tenet of Democratic vows to protect benefits come what may.

But Mr. Greenspan conspicuously avoided any mention of the solution eagerly proposed by President Bush and many other Republicans: to partly privatize the Social Security system by letting people divert some of their payroll taxes to individual savings accounts that they would control.

Noting that the share of the American population older than 65 will climb from 12 percent to 20 percent by 2035, the Fed chairman said the United States needed to increase savings, increase spending on education and maintain the pace of productivity growth.

Heightened productivity growth of workers "offers the greatest potential" for allowing the country to support its aging population without lowering the overall standard of living, he said.

But higher productivity will require continued investment, and the United States' savings rate remains very low. Federal deficits, which have hit records under President Bush, have also depressed the national savings rate and increased the nation's need to borrow money from abroad.

"The decade-long acceleration in productivity and economic growth has seemingly muted the necessity of making such choices" between reduced benefits or higher taxes, Mr. Greenspan said. But, he warned that "history discourages the notion that the pace of growth will continue to increase."

If the population over 65 years of age doubles by 2035, he continued, federal deficits will substantially increase.

"But how these deficit trends are addressed can have profound economic effects," Mr. Greenspan said. Increasing payroll tax contributions could make the problem worse, by possibly reducing the incentives for workers to continue working.

Without going into details, the Fed chairman said that benefit formulas could be adjusted so that entitlements to retirees in the future climb more slowly than they would under current law.

"Early initiatives to address the economic effects of the baby boom retirements could smooth the transition to a new balance between workers and retirees," he said.

In an implicit attack on the new expansion of Medicare to provide some prescription drug benefits, which is expected to cost more than $530 billion over the next 10 years, Mr. Greenspan said policy makers "must be especially vigilant" to create benefits only when they can truly be afforded.

Mr. Greenspan made his comments at the start of the Federal Reserve Board's annual economic symposium, which is devoted this year to the economic impact of global demographic changes.

But the issue is also a backdrop to the presidential election campaign. President Bush and many Republicans are promoting the idea of replacing part of the traditional Social Security system with private savings accounts.

The Democratic nominee, Senator John F. Kerry, has opposed such plans and has vowed to ensure that benefits are not reduced in the future.

Neither candidate has addressed the long-term challenges in any detail. Most analysts say that the looming financial shortfalls of Social Security are relatively modest and can be addressed by incremental changes to benefit formulas and a gradual delay in retirement ages.

The problems confronting Medicare are expected to be far more severe, because costs have been rising rapidly per person at the same time that the population of retirees has been increasing.