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BROOKINGS CAFETERIA PODCAST

America's aging population could worsen the federal budget problem

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DEWS: Welcome to the Brookings Cafeteria, the podcast about ideas and the experts who have them. I'm Fred Dews.

The United States' population is aging as members of the Baby Boomer generation continue to age and retire, and as American fertility declines. This permanent demographic transformation has significant implications for the long-term federal budget. Here to discuss the issue and possible solutions is Louise Sheiner, who is the Robert S. Kerr senior fellow in economic studies and policy director for the Hutchins Center on Fiscal and Monetary Policy at Brookings.

She has served as an economist with the Federal Reserve, was deputy assistant secretary for Economic Policy at the U.S. Treasury Department, and was a senior staff economist for the Council of Economic Advisors in the White House. And she is the author of a new paper titled "The long-term impact of aging on the federal budget."

Stay tuned in this episode to find out what's happening in Congress from Molly Reynolds.

You can follow the Brookings Podcast Network on Twitter @policypodcasts to get the latest information about all of our shows. And now, on with the interview. Louise, welcome to the Brookings Cafeteria.

SHEINER: Thank you. Thank you for having me.

DEWS: All right. So you have this paper, "The long-term impact of aging on the federal budget." It's a Hutchins Center working paper.

I'm going to get to that in a second, but first of all I'd like to ask you about your educational and professional background, especially I noticed on your bio on our website, you have an undergraduate degree in biology and now you have a doctorate in economics.

SHEINER: Exactly. Yeah, so I came to economics very late in the game. I did not take any economics classes at all until my senior year when I took Economics 101 at Harvard. It was actually called EC 10, and I had to take it if I wanted to take another class I was interested in, which was food policy. And you know, it was one of these cases where I was like, loved the textbook, loved this, don't know why I never took it before, and just, you know, decided this is what I wanted to do. So I worked for a few years before graduate school at a consulting firm in

Washington with an economist, taught myself macro, enough to take the GREs in economics, and got into a program which was pretty amazing.

DEWS: Great. So it just clicked. Economics just clicked?

SHEINER: Oh, yeah. It was definitely just very much right up my alley. And you know, what's interesting is I was doing ecology by the time I was a senior in a biology major. I had kind of moved to environmental biology. And it's not all that different; right? You think about survival of the fittest is a biology concept, but it's also an economic concept. So it kind of made sense.

DEWS: I'm going to submit that I didn't do so well in economics in undergrad. I was a Soviet Studies and Russian Studies major, but look what happened to that.

Anyway, let's talk about your paper again, "The long-term impact of aging on the federal budget." Just broadly stated, why is the federal budget affected by population aging?

SHEINER: So the federal budget is affected by aging because we spend a lot of money on programs that are intended to finance the consumption of the elderly. So in particular, Social Security, which is our public pension program, and Medicare, which is a public health insurance program for those who are 65 and older mostly. So because we spend a lot of resources on programs that are for the elderly, as the elderly increases a share of the population, that increase is spending on these two programs. And so that really makes aging a challenge for the budget.

DEWS: So what are the data on population aging if we're looking at the over 65 population, what percentage is the population now? What was it? What's it going to be?

SHEINER: So, the population 65 and older was about 12 percent of the economy in the early 2000s, and it's moved up to about 15 percent now, and in about 20 years it should move to about 21 percent. And so we're seeing this very fast transition from one age structure to another. And we're about one-third of the way through it.

DEWS: And I think what's really interesting that I learned from this paper and other work that you've done on our website, it's not just the Baby Boomers you're retiring; right? I mean, that's what everyone assumes, there's a huge age cohort of people, they're all starting to retire now, and so America is getting a bit older. But then it would snap back to what it was.

SHEINER: Exactly. It's very, very important to realize that this is not something temporary. And if it were temporary, it wouldn't be as much of a challenge. You know, you can have some temporary problems but you can smooth through them. But really what this is, is a transition to a permanently older population, and that's driven by two factors. One, which is not new, it's been happening sort of all along, is that people live longer. So when people live longer, the population 65 and older obviously grows. But really what's happening, the big transition is when the Baby Boomers were born, parents had about three kids, and then after the Baby Boomers generation that moved to about two kids per family. And unless that switches back, which we don't anticipate, that means that the age population will be forever older, because if you think about the number of kids every parent has, you know, fast-forward that 20 or 30 years, that's basically the ratio of old people to working-age people.

DEWS: And that's a particular problem for Social Security; right?

SHEINER: For Social Security and for Medicare, which both rely on payroll taxes basically to finance benefits.

DEWS: So can you talk about then what are those direct effects of the aging population on those two programs that you mentioned, Social Security and Medicare?

SHEINER: So the way to think about it is you think about how big are Social Security and Medicare relative to the size of the economy, and that sort of gets both the fact that we don't have as many workers as we would have had if we had higher fertility and the expenditures on old people for Social Security and Medicare. And so what we have is actually between now and for the next 25 years, spending on Social Security and Medicare as a share of the economy will increase about 50 percent. And about one-third of that increase is due to Social Security, and about two-thirds is due to Medicare. And the reason Medicare increases much more than Social Security is we actually have two forces that are increasing pressure on the budget. So we have aging, which increases the share of population at 65 and older, and we also have health spending that increases fairly rapidly historically relative to the size of the economy. So when you combine those two and the Federal Government is paying for the health spending of older people, when you have fast-growing health spending and a fast-growing older population, those two just reinforce each other and make Medicare growth really quite rapid.

DEWS: I saw a chart recently somewhere that kind of tracked the growth of different kinds of spending over the last couple of decades and projected it out. And you see things like cars and televisions and houses going up, going down, but not that much. But healthcare spending is just the highest sloping chart. It's really amazing. So it's not just like healthcare spending is growing kind of at the same rate. It's really growing a lot more than everything else.

SHEINER: Exactly. So if you think about healthcare spending as a share of GDP, in 1975, this is total, not just federal, but total health spending was about eight percent of GDP and today it's about 18 percent. So it's not just growing along with the economy; right? It's growing much faster than the economy. And we project that that will slow over time but still continue.

DEWS: So I'm going to take a quick side detour into this question of making these long-term projections that you have in these papers. We talk about 20-year forecast, 30-year forecast. There's the Congressional Budget Office. You worked at the White House in the Council of Economic Advisors and at the Fed. And I've had guests on this show who have worked for the Treasury and other kinds of economic forecasting places. I mean, how do you make these kinds of assumptions? Could they be overstating the problem? Could they be understating the problem?

SHEINER: Yeah, so actually there's two ways to think about this. First of all, you have to remember what these projections are. These projections are projections assuming that the law stays the same. So they're not really forecasts because I don't think the law will stay the same. I think the law is going to have to adjust to these higher rates of spending growth. Otherwise, we just have huge deficits and huge debt. But this is really giving you what happens if you don't change the law? Then the question is, how good are those forecasts? Right? Let's assume that the law stays the same and then these forecasts are very difficult to do because we're forecasting how big is the economy? What's going to happen to productivity? What's going to happen to labor force participation? What's going to happen to interest rates, to healthcare costs? All those things matter. And they're all very difficult to forecast; right?

One thing that we do have a pretty good idea about is that we are going to be aging. The number of older people, you know, that we're going to have and the number of workers we're going to have, because we already have kids. You know, so we sort of know that part pretty well. But even there we don't really know what's going to happen to life expectancy. So there's some uncertainty there.

Now, CBO has done some sensitivity analysis about sort of the most important economic assumptions and you can see there that the bandwidth is very, very high. So they think about the likely up and downsides for interest rates, labor force participation, health spending, and productivity. And if you take the worst case scenario where everything is worse than our best guess, right, but plausible, but they all happen at the same time, everything is worse, then instead of getting to 150 percent of GDP, which is what we now forecast for the debt-to-GDP ratio in about 30 years, it gets to 244 percent of GDP.

But, on the other hand, if things are better off, right, everything comes to the upside, right, oh, productivity improves more than we think and interest rates are lower than we think and health spending doesn't grow nearly so fast as we think, then actually we don't necessarily have a big problem. And even without law changes our debt-to-GDP ratio would only go up a little bit over time. So you can see there really is a very wide band. And so it's hard to know exactly what challenges we're going to face, but the way we do it is we do our best guess and we know that there is some uncertainty over it. And if you think about how policy changes, it evolves over time; right? So if it turns out things are much better, then probably we'll make fewer changes.

DEWS: Well, and I want to get to the idea of changes here in a minute --

SHEINER: Yes.

DEWS: -- because that's an important component of your paper is the policy changes that we need to make. But first I want to ask you to talk about what we call the indirect effects of population aging since aging and its effect on Social Security and Medicare outlays are some of the direct effects, we've just got to spend more money on the aging population, but there are some indirect effects as well.

SHEINER: Yeah, there definitely are. I would say that these are a lot more uncertain. And there's two that I would point to. One that people have talked about is the effect of aging on interest rates. So one thing that has been surprising economists over the past decade is how low interest rates are now even though our debt-to-GDP ratio has increased a lot, and yet interest rates are extremely low by historical standards, and most people think that they're going to stay low. And one hypothesis is that part of that is a response to aging which is a possibility. So aging itself through various mechanisms, and because we have a slow-growing workforce that means our capital per worker increases and that lowers the rate of return. So sort of very technical issues on interest rates that say aging may itself contribute to low interest rates. And that's a very good thing from the federal budget's perspective. Because we have a high level of debt, when interest rates are low that debt is much more manageable; right? It's like if you had a big mortgage but your interest rates were low, then it wouldn't be such a big deal. So in that sense, if that's true that the slowdown in interest rates is part and parcel because of aging, then aging is less bad, you know, for the budget when you think about it.

On the other hand, we've also had a slowdown in productivity growth, right, and that's kind of the growth that determines how fast living standards change over town. We've had a slowdown in the past 10 years, and some people attribute that to the impact of aging, although I would think that there's much less consensus on that and the theory is even murkier as well. But basically, the idea would be that an older population, that older workers are less productive than when your workforce gets older your productivity might slow.

That's not clear. There's also other factors that would say, well, but it's also possible that what's happening is as your workforce grows slow, that firms will automate more. We hear a lot about robots and that would boost productivity. So I think that that's a lot murkier but that connection is quite important because productivity is one of those things that drives how bad our budget problems are. It's an important driver. And so I think that's an area that people will be researching a lot more in the next few years.

(Music plays)

DEWS: And now, what's happening in Congress.

REYNOLDS: My name is Molly Reynolds. I'm a fellow in the Governance Studies program at the Brookings Institution.

Congress isn't up to much in Washington this week because both chambers are on recess and members are back in their states and districts, or in some cases, on international junkets. But even when they return to the Capitol in a few weeks, don't expect much legislation to be headed to the president over the next several months.

Before breaking for recess, Congress did complete work on a $1.3 trillion spending bill that allocates funds for various discretionary programs, including the Department of Defense, scientific research, K-12 education, environmental programs, and many others. The overall amount of money available for these programs was set when Congress reached a two-year budget deal in February and then Congress spent six weeks working to fill in the details of where exactly that money would go. The Spending bill had to survive opposition from some House Republicans, with only about 60 percent of the Republican conference in that chamber voting in favor of it. It also had to overcome a last-minute surprise veto threat from President Trump, who was unhappy with the levels of funding provided in the bill for construction of a border wall and with the restrictions on how that money that is appropriate can be used.

The omnibus will deliver needed federal funding to programs on which Americans rely, and in many cases at levels above those originally requested by President Trump. Finishing the appropriations process five months past the start of the fiscal year isn't necessarily something to write home about but the omnibus spending bill is likely to be the most consequential piece of legislation Congress gets done for the next several months.

In early March, House Majority Leader Kevin McCarthy laid out some of what he sees as the chamber's agenda for the next several months. Several of the items on it are what we consider messaging bills or measures supported by one party and opposed by the other party that aren't expected to become law. These include a balanced budget amendment to the Constitution and reforms to the Internal Revenue Service. Leaders in both chambers have also discussed scheduling a series of votes to make the tax cuts passed by Congress and signed into law by the President in December permanent.

How do we know these are messaging votes? A balanced budget amendment, for example, is extremely unlikely to get the two-thirds votes in both chambers that will be required. Tax cuts may attract the votes of some Democrats, indeed forcing vulnerable Senate Democrats to choose whether to support or oppose more tax cuts is likely part of Republicans' goal in scheduling those votes. But it's unlikely that such a bill could get the 60 votes required to clear the threat of a filibuster in the chamber.

What's more, Republicans appear to be leaving one of their biggest legislative buttons, the budget reconciliation process, unused this year. Reconciliation, which allows for the passage of some budgetary legislation without the threat of a filibuster in the Senate, would allow Republicans to achieve other goals, including cuts to certain social programs, without the need to court democratic votes. But writing a reconciliation bill first requires adopting a blueprint, notice the budget resolution, in both chambers. Republicans seen unlikely to take that necessary first step this year in part because wrangling the votes for it even within their own party would be a heavy lift.

So why are congressional Republicans leaning heavily on messaging bills? Work by political scientist Jeremy Gelman suggests that majority party legislators are often rewarded by their interest group allies outside the chamber for advancing bills inside the chamber that they know will fail. With Republicans, especially in the House, facing difficult electoral headwinds in November, they may see focusing on issues popular with key allies as a better use of their time than fighting for compromises with Democrats.

While the outlook for legislation over the next several months is bleak, the Senate at least has plenty of nominations to keep it busy. There are roughly 100 nominations currently pending on the Senate's executive calendar, and personnel decisions made by President Trump over the past several weeks have created potentially contentious vacancies heading the State Department, the CIA, and the Department of Veterans Affairs. So even if Congress sends few major bills to the president in the coming months, something will still be happening in Congress.

(Music plays)

DEWS: So I think this next point helps us transition into some of the thinking about solutions to this budget problem, although this one might be less direct than some kind of policy intervention.

You write in the paper that the “fundamental challenge to population aging is that it increases the ratio of nonworkers to workers.” You mentioned this a few minutes ago. How can that ratio be reduced?

SHEINER: Right. So when we do these estimates of what’s happening to aging, we use a number like age 65. That’s what an elderly person is. But that doesn’t have to be the case; right? So if we really think that the final banal issue is that we have too many people who are consuming but not working, then the way to fix that is to kind of change that ratio; right? So to take some people who are out of the labor force and put them back in the labor force. And you can think you can do that by sort of in two broad ways. One is you can say, well, you know, people are living longer, they’re healthier, so why should they be retiring at 65; right? Maybe we can push that up. All right. So that’s one way of doing it. And if you do that and at the same time, you know, stop giving them Social Security and Medicare, delay that as well, then you can save money that way.

Another way that doesn’t save directly money on Social Security and Medicare but sort of changes your economic base and your tax base would be increasing labor force participation of people who are younger than 65. I mean, one of the things that I focus on in the paper is that there is this, you know, for a long time women were catching up to men in terms of labor force participation and I think people thought that those trends would continue and eventually that they would participate in the labor force as much as men. But that’s not the case. Women still have a markedly lower labor force participation rate than men. It basically sort of leveled off around 2000; right? They stopped converging. So another possibility is if you could think of policies that might encourage labor force participation rate of women, that wouldn’t sort of lower Social Security and Medicare expenses directly but it would increase the tax base that is used to fund them.

DEWS: What about additional immigration that could increase the population of working age adults, or even just the millennial boom that I’ve talked to other Brooking scholars about, like William Frey, on this new generation? There’s also a very large generation of up and coming young adults who are working.

REYNOLDS: Well, so the millennial boom is sort of in the projections obviously; right? So they were still the product of fertility of two, right, so they don't really compare in size -- or they compare in size but in terms of the relative size to the Baby Boomers.

But immigration is a different issue. So immigration is another way of increasing the population, and since immigrants typically come when they're younger than 65, then they can help Social Security, Medicare, and the federal budget in general. The estimates that people have looked at -- think about raising immigration by maybe 100,000, 200,000, 300,000 a year. That's kind of what is viewed as politically feasible, possibly. And those are enough to help a little. But they're not enough to solve the problem. They have a bigger impact at first when they come in and they're working but then, of course, they're eligible for Social Security and Medicare when they get older. They're still a net positive. That's what the estimates suggest, but it's not likely that we're going to completely solve the problem by increasing immigration.

DEWS: And as you've written in the paper, this is a permanent problem, the population aging. So we're still looking at these negative effects on the federal budget, maybe increasing the labor force participation and increasing immigration, increasing women's labor force participation will help a little bit but not a lot. Is that accurate?

SHEINER: I think that's right. I think that most of the adjustments are not going to be sort of so easy and that nobody has to sacrifice. I think we're going to have to make some hard choices when it comes to spending and taxes.

DEWS: All right. So spending and taxes, those are the two big areas that we'll look at now. And we're talking about the level the Federal Government is spending and federal taxes?

REYNOLDS: Exactly.

DEWS: And we're talking about cutting spending and raising taxes?

SHEINER: Exactly.

DEWS: So two totally noncontroversial issues there.

SHEINER: Things we don't like to do.

DEWS: So how much would federal spending have to be cut or taxes be raised?

And do they have to happen kind of at the same time? Does one happen before the other? Is there some mix?

REYNOLDS: Well, so there's sort of two issues to think about here. One is the timing; right? How important is it that we sort of get to this right now? That's a policy question. And then the second question is sort of, okay, what is it that we do?

Now, let me talk about the timing first and then I'll talk about what it is that we do.

So the timing really depends on how worried you are about debt. So we really haven't talked about the projection for debt to GDP yet, but one implication of this increased spending on Social Security and Medicare is that if we don't change laws we're going to be running big deficits in the future which is going to be running up our debt, and getting debt-to-GDP ratios I said about 150 percent I think in 30 years.

So that's a gradual process; right? Debt is already at 77 percent of GDP. It's pretty high by historical standards and under the baseline we see this gradual increase over time. So the question is how bad is debt? One of the things I talked about already was that interest rates are very low now. With interest rates so low, debt isn't that bad. It's not that unmanageable. We're not spending a ton on interest and crowding out other spending right now. That gives us some breathing room. It says it's not a dire emergency to make the changes right now; right? So if you aren't worried that these low interest rates are just temporary and they're about to jump right up, then you might say, well, we have some breathing room. Of course, we don't really know. I mean, we have some risk from having a high level of debt because we don't really know what interest rates are going to be, but I do think there is some breathing room, that the fact that interest rates are lower than the historical average says it's not as dire.

On the other hand, when we tend to make changes, we exempt current retirees. We say it's not going to start for another 10 years, so it's certainly time to start thinking about what changes those should be regardless of whether or not we sort of rush to implement them now or we take our time; right? And the magnitude of what we have to do will depend to some extent on when we do it; right? The earlier we do it, the less we have to do, but not by a ton, I think is the right way to think about it.

In terms of how big, let me just give you one number. Because as I say, it really depends on when. But if we acted now, and if what we said is what we want is to make some changes now that would bring the debt-to-GDP ratio in 25 years to today's level, so don't let it climb. Make sure it doesn't go any higher. Then we'd have to make changes of about 2.5 percent of GDP; right? So if we think about taxes, taxes are about 18 percent of GDP, so 2.5 out of 18, that's kind of the magnitude of the changes that we need to make if we made them right now; right? If we wait longer, then the changes have to be bigger. Okay?

When it comes to the what, then you really realize that, you know, what government does, spending and taxes, is not really just an economic question. It's a question that really comes down to values in a way. There are some economic analyses that you might want to consider and some economy facts that I think you should consider when thinking about the what. But fundamentally, it's a political question of, you know, what the nation's priorities are.

The economic factors that I think are very important to consider are, one, we've had this very rapid increase in inequality. We've had a rise in income inequality. We've had an increase in inequality of how long people live, right, the gap between the lowest income people and the highest income people and how long they live has widened considerably. To me, that all says that when you start making changes you should be trying to protect the bottom. That's my values. The other ones are facts but my values say you respond to those by making sure that you don't increase inequality by your changes because inequality has already increased.

The other things you want to consider is that some government spending is really investment; right? And so spending on poor families has shown to have great returns. Spending on education might have very high returns. You know, you want to think carefully when you're deciding what to cut and what not to cut, whether or not you think you're cutting things that actually improve the long-run outlook; right? So, you know, the example I always use thinking about it would not make sense to say, well, we can't afford to get rid of the lead in water pipes because lead is so bad and getting rid of the lead would increase wages, increase educational attainment, improve health, all the things that will cost money in the future; right?

So those are sort of the economic facts. But then what you do is really up to you and depends on your values. And actually, at the Hutchins Center we have a game. And the game is called the Fiscal Ship. And you can find it at fiscalship.org. And what the game says is you have to get the debt-to-GDP ratio in 25 years no higher than today's. You have to do that to win the game, but before you do that, before you even start playing, you have to say what your values are; right? What do you think government should be doing? Should it be reducing inequality? Should it be strengthening national defense? You know, are you a fiscal hawk and think that the budget debt is way too high? Are you a shrink government person? Are those your values that you don't think government should be quite as large as it is? You know, you specify your values and then you have to choose policies that both meet your values and sort of get the numbers right, get the debt-to-GDP ratio in 25 years no higher than today. And I think as an economist that's the best we can do. Here are the tradeoffs and then the rest is up to your values.

DEWS: Well, then, is an approach like that that focuses on cutting spending the right approach or does it have to be a mix? Or do we have to look at raising taxes as well?

SHEINER: Raising taxes. So there are definitely tax increases in the game. There's many kinds of tax increases. You know, and again, it really depends. I mean, if you're someone who thinks the government is already way too big, you might say I want to do it on the spending side; right? If you think, no, I actually value a lot of what government does, and I realize that this structural change is coming from aging, it's not because we've been like throwing money at Social Security. It's really not that each person is going to be getting more in Social Security. It's just there are more people relative to the size of the economy. And then you might say, look, with this structural change, if I value the social safety net and I value Medicare and Social Security and everything else the government does, then there's no way to do that without raising taxes; right? And so that's what I say. You have to decide on what's important to you. Would you rather have higher taxes and more government spending or lower taxes and less government spending?

DEWS: So do you have a sense of given the two components of this, cutting spending, raising taxes, should one be favored over the other in some way?

REYNOLDS: I mean, I have my preferences, obviously. I mean, I happen to really like a lot of what the government does, and so I think raising taxes is important. I don't think politically it will ever be solved all on the tax side or all on the spending side. I think we're going to inevitably get some combination of the two. I'm not sure when that's going to happen since we just had legislation that increased spending and cut taxes, so we're not certainly at that point where people are ready to make those compromises. But I think when we are, then the solution is going to probably be somewhere in between.

DEWS: Well, I hope that all the policymakers now and in the future pick up a copy of this paper and look at your other research and play the Fiscal Ship game because it's such an important issue and it touches on so many important aspects of our lives.

Louise, I want to thank you so much for sharing your time and your expertise today.

SHEINER: Great. It's been a pleasure. Thank you.

DEWS: You can learn more about Louise Sheiner and her research on our website, Brookings.edu, where you can also play the Fiscal Ship game.

(Music plays)

My thanks to audio engineer and producer Gaston Reboredo with assistance from Mark Hoelscher, to producers Brennan Hoban and Chris McKenna. To Bill Finan, who does the book interviews, and to Jessica Pavone, Eric Abalahin, and Rebecca Viser for design and web support. Thanks also to our intern, Steven Lee. And finally, thanks to Camilo Ramirez and David Nassar for their guidance and support.

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Until next time, I'm Fred Dews.