Written Testimony for the Joint Economic Committee
Aging Americans and a Waning Workforce: Demographic Drivers of our Deficit

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Thank you to Chairman Heinrich, Vice Chairman Schweikert, and members of this committee for inviting me to testify at today's hearing. I am honored to appear before you to examine topics that I've studied throughout my career in public service and academia, in particular the intersection between an aging population and long-standing fiscal imbalances. Since the U.S.'s demographic shifts play an important role in this discussion, my testimony today will explore the ways an aging population can contribute to a deteriorating fiscal outlook, before presenting a menu of policy approaches that can mitigate these trends.

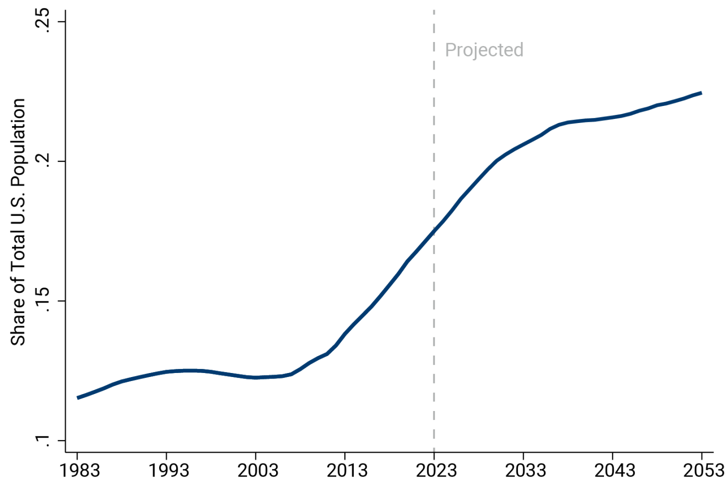
The Consequences of an Aging Population on the Fiscal Outlook

Over the next few decades, the United States will be forced to address the fiscal challenges of an aging population. Our nation is in the midst of a rapid demographic transition where the share of Americans aged 65 and older increases by roughly 0.4 percentage points per year between 2012 and 2030, over which time their population share will increase from 13 percent to 20 percent—with a slower rate of aging both before and after this quarter-century period (see Figure 1).[1,2] While the labor market impacts of this shift will be somewhat mitigated by increased labor force participation of older workers—the Bureau of Labor Statistics projects that between 2016 and 2026 the labor force participation rate of workers 65 and older will increase by 2.5 percentage points[3]—the ongoing aging of the population will define our fiscal challenges for the foreseeable future, making demographic shifts one of the most important economic trends today and moving forward.

[1] Congressional Budget Office, "The 2023 Long-Term Budget Outlook," June 28, 2023, https://www.cbo.gov/publication/59014.
[2] The Census Bureau similarly predicts that one-in-five Americans will be 65 and older by 2030. Jonathan Vespa, Lauren Medina, and David M. Armstrong, "Demographic Turning Points for the United States: Population Projections for 2020 to 2060," *U.S. Census Bureau*, March 2018 (revised February 2020), https://www.census.gov/content/dam/Census/library/publications/2020/demo/p25-1144.pdf.
[3] Bureau of Labor Statistics, "How Are Our Older Workers Doing?" *Commissioner's Corner*, May 20, 2019, https://www.bls.gov/blog/2019/how-are-our-older-workers-doing.htm.

FIGURE 1

Population 65+ As a Share of the Total U.S. Population



Source: Congressional Budget Office

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This ongoing demographic transition has contributed to a sobering, and perhaps even dire, fiscal outlook. The Congressional Budget Office's (CBO) long-term budget outlook projects that the national debt will reach 181 percent of Gross Domestic Product (GDP) by 2053—far above recent historical experience—and multiple independent analyses paint an even more pessimistic picture.[4] Ongoing concerns such as stagnating labor force participation, slow rates of productivity growth, and weak population growth—owing to low fertility rates and modest rates of immigration—contribute to this increase, but a consequential factor is increased entitlement spending due to an aging population and rising economywide health costs.

Stagnant rates of revenue growth, with tax revenues as a share of GDP that are lower than many competitor nations, have played an outsized role in driving persistent imbalances. The Tax Cuts and Jobs Act of 2017, projected by CBO to increase deficits by $1.8 trillion over ten years,[5] has exacerbated the insufficient nature of the tax code. Over the next decade, even with a steadily growing economy and a healthy labor market, CBO projects that the primary budget deficit from 2024 to 2033 will amount to 2.9 percent of GDP, representing a structural imbalance divorced from macroeconomic fluctuations. As I will detail below, the path to addressing the long-term fiscal imbalance necessitates changes to our tax code to raise more revenue.

Rising interest payments on the US debt also bear special mention. While there is uncertainty about the path of future interest rates, the recent rise in ten-year Treasury bond yields—which some have attributed to increased concern about fiscal imbalances—suggests that debt service will rise sharply in the coming years.[6] In fact, CBO's outlook estimates that interest payments on the

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[4] For example, Committee for a Responsible Federal Budget, "Analysis of CBO's June 2023 Long-Term Budget Outlook," June 28, 2023, https://www.crfb.org/papers/analysis-cbos-june-2023-long-term-budget-outlook, and Alan J. Auerbach and William G. Gale, "The Federal Budget Outlook: An Update," *Tax Notes*, August 21, 2023, https://www.taxnotes.com/special-reports/budgets/federal-budget-outlook-update/2023/08/18/7h286.

[5] Congressional Budget Office, "The Budget and Economic Outlook: 2018 to 2028," April 9, 2018, https://www.cbo.gov/publication/53651.

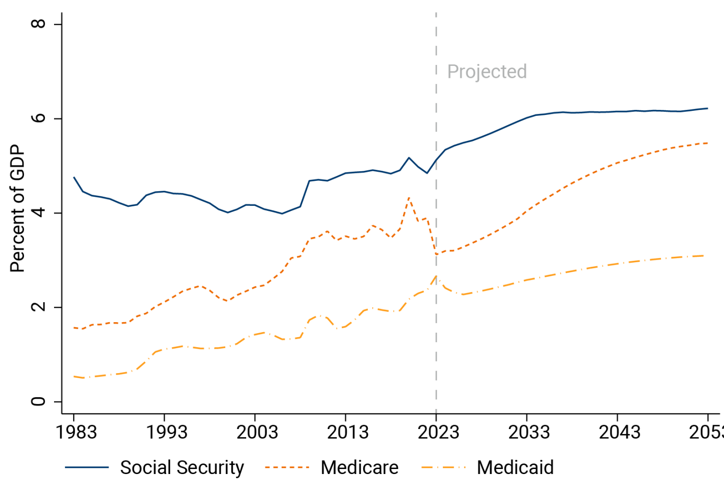
[6] US Department of the Treasury, "Report to the Secretary of the Treasury from the Treasury Borrowing Advisory Committee," *Press Releases*, November 1, 2023, https://home.treasury.gov/news/press-releases/jy1865.

national debt will eventually become the single biggest expenditure item at 6.7 percent of GDP in 2051—exceeding even Social Security outlays. Assuming annual inflation rates around the Federal Reserve's 2 percent target, this interest burden would far surpass the level (2 percent of GDP in real terms) that some macroeconomists consider sustainable,[7] leading to far-reaching consequences for fiscal sustainability and the growth rate of the US economy.[8]

In the absence of corrective action, the spending increases required by an aging population pose a threat to our nation's long-term fiscal health. Mandatory spending currently makes up 70 percent of all non-interest spending, and major entitlement programs—Social Security, Medicare, and Medicaid—comprise 72 percent of all mandatory spending.[9] The current demographic shift will put increasing pressure on these entitlements—all three are projected to reach all-time high levels of spending as a percent of GDP in the next 20 years (see Figure 2). While substantial shares of Social Security and Medicaid outlays service the under-65 population, the central point is that entitlement spending will soon reach levels that are far outside the historical experience.

FIGURE 2

Projected spending on entitlement programs



Source: Congressional Budget Office, author's calculations

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The aging of the population, combined with a national commitment to providing retirement-age Americans with income and health care support and a tax code with generous tax incentives for retirement saving, has led to a massive share of national income devoted to retirement. To better quantify the relationship between an aging population and the current fiscal crisis, Figure 3 below provides a crude illustration of the growth in the share of GDP devoted to public support for retirement. As shown graphically, the share of retirement spending—defined as major elements of mandatory spending directly associated with retirement-age Americans plus tax expenditures

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[7] Jason Furman and Lawrence Summers, "A Reconsideration of Fiscal Policy in the Era of Low Interest Rates," *Brookings Institution*, November 30, 2020, https://www.brookings.edu/wp-content/uploads/2020/11/furman-summers-fiscal-reconsideration-discussion-draft.pdf.

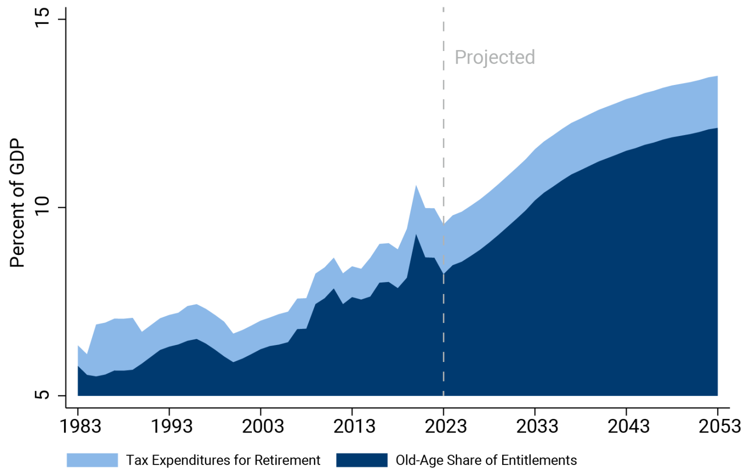
[8] Benjamin H. Harris and Adam Looney, "The Tax Cuts and Jobs Act was a missed opportunity to establish a sustainable tax code," *Tax Policy Center*, May 24, 2018, https://www.brookings.edu/wp-content/uploads/2018/05/es_20180524_harris-looney_taxreform.pdf.

[9] Congressional Budget Office, "The 2023 Long-Term Budget Outlook," June 28, 2023, https://www.cbo.gov/publication/59014.

designed to support retirement—continues a trend since the turn of the century and rises steadily over the next three decades.[10] Specifically, federal retirement spending as a share of GDP rises from 9.5 percent in 2023 to 13.5 percent in 2053. Importantly, this calculation is not intended to suggest that the federal government *should* spend less on retirement policy, but rather illustrates that a massive share of our national income supports various aspects of retirement.

FIGURE 3

Retirement Spending as a Share of GDP



Source: SSA, CMS, JCT, CBO, and author's calculations

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Policy Strategies to Address Longstanding Fiscal Imbalances

At some undetermined point, persistent and rising fiscal imbalances will demand policy action. While the precise trajectory of the economic costs of rising debt is unclear, the sharp recent rise in real interest costs—the 10-year real interest rate has risen from about -0.3 percent to +2.1 percent between August 2021 and October 2023—suggests that increased near-term attention by policymakers is warranted. The remainder of this testimony will advance a broad menu of policy strategies that could plausibly be adopted to correct longstanding fiscal imbalances associated with an aging population, while also highlighting several strategies that will prove insufficient.

[10] The data for Figure 3 were drawn from a collection of government sources, including: Centers for Medicare and Medicaid Services, "Health Expenditures by Age and Sex," 2020, https://www.cms.gov/data-research/statistics-trends-and-reports/national-health-expenditure-data/age-and-sex; Congressional Budget Office, "The Distribution of Major Tax Expenditures in 2019," October 2021, https://www.cbo.gov/publication/57585; Joint Committee on Taxation, "Background Information on Tax Expenditure Analysis and Historical Survey of Tax Expenditure Estimates," February 6, 2015, https://www.jct.gov/getattachment/bf98a247-1c24-472a-8b3a-6a71470712e9/x-18-15-4705.pdf; Social Security Administration, "Annual Statistical Supplement to the Social Security Bulletin, 2022," December 2022, https://www.ssa.gov/policy/docs/statcomps/supplement/index.html.

All Medicare data and the proportion of the population 65 and older is sourced from CBO (2023). Historical data on Social Security and Supplemental Security Income (SSI) expenditures for retirement-age Americans is sourced from SSA (2022) and projected spending is extrapolated using the 2020 ratio of retirement-age Social Security and SSI spending to their respective totals in the CBO (2023) projections, scaled to account for the growing retirement-age population. Historical data on the 5-year average for tax expenditures is sourced from JCT (2015), and current and future tax expenditures for retirement are calculated using data from CBO (2021) scaled by the demographic projections of CBO (2023).

Unfortunately, as outlined in the first section of the testimony, the large-scale magnitude of the imbalance demands more than incremental policy changes. Importantly, too, this menu of options represents the full spectrum of available approaches: in the opinion of this witness, there are limited, if any, other plausible alternatives.

Before turning to conceivable strategies, it is useful to first acknowledge potential approaches that should not be adopted, either because they are insufficient to address the magnitude of the shortfall or because the negative economic consequences would prove too severe to warrant their adoption. One, cuts in non-defense discretionary spending—a central approach embodied in the Fiscal Responsibility Act of 2023—would drive federal spending on this category well below historical trends[11] and ultimately harm economic growth. Given that this umbrella category of spending comprises the bulk of federal outlays on non-defense "public goods," further sharp cuts in areas like research and development, job training, and childcare would lead to a less productive economy with a smaller labor force—ultimately harming economic growth.

A second ill-advised approach is to utilize the debt limit as a tool for forcing fiscal changes. While the threat of breaching the debt limit, and perhaps igniting an economic recession, eventually led to the adoption of discretionary budget cuts in 2011 and 2023, such a strategy undermines the credibility of the United States as a borrower in global financial markets, leading to higher interest rates and—at least in 2011—steep declines in financial asset prices.

A third insufficient approach is to abandon Keynesian stimulus in times of economic downturns. The US government and Federal Reserve are the primary entities that intervene in economic policy to prevent recessions from expanding into depressions. The US government's fiscal intervention, which often enjoys some measure of bipartisan support, has successfully limited the length and depth of recent recessionary periods; abandoning this role for the federal government would exacerbate the economic pain of business cycle downturns and ultimately worsen long-term fiscal pressures.

With these caveats noted, this testimony will catalog more promising approaches for achieving an improved fiscal outlook.

Raising tax rates on income or wages: The most straightforward approach to raising more revenue is to increase statutory tax rates on income or wages. Such a policy reform carries an economic cost in terms of discouraging additional work or investment, although the extent to which higher tax rates impose an economic cost depends critically on the nature of the income taxed and the taxpayers who are subject to higher tax rates. In particular, economists tend to focus on marginal tax rates—the tax imposed on an incremental change in income or wages—to assess the economic impact.

In aggregate terms, marginal tax rates are slightly below the level experienced in the 1980s and are currently in line with historical averages. According to CBO, the marginal tax rate on labor income under both the individual income and payroll tax systems in 2023 is 27.9 percent—with a

[11] See, for example David Reich and Richard Kogan, "Congress Should Reject Proposals to Cut Non-Defense Program Funding," *Center on Budget and Policy Priorities*, March 8, 2023, https://www.cbpp.org/sites/default/files/3.7.23fedbud.pdf.

marginal tax rate of 19.3 percent under the individual income tax system and a marginal tax rate of 8.6 percent under the payroll tax.[12] To take one example, raising the payroll tax rate by 1 percentage point would close over 20 percent of the 75-year fiscal imbalance in Social Security.[13] Notably, too, marginal tax rates on capital income remain below historical norms, and represent an opportunity to raise additional revenue.

Reversing the steep reduction in the corporate tax rate enacted in 2017: Legislation passed in 2017 permanently and sharply cut the corporate tax rate from 35 percent to 21 percent, which propelled a steep reduction in corporate tax revenues. Today, corporate tax revenue amounts to roughly 1-2 percent of GDP, down from an average level of under 4 percent in the 1960s.[14] While a return to the pre-2017 tax rate would be ill-advised given other reforms in that bill, instituting a tax rate of 28 percent would raise over $1.3 trillion over the ten-year budget window,[15] with limited economic costs in terms of reduced investment.

Eliminating major tax expenditures: Tax expenditures are losses in revenue owing to a "special" provision designed to achieve a social or economic objective.[16] Some of the larger and more well-known tax expenditures include the exclusion of employer-provided health insurance, preferential rates on capital gains, and the deduction for home mortgage interest. The aggregate size of the tax expenditure budget has varied over time with changes to tax policy and the economy, but in recent years the tax expenditure budget has begun to approach $2 trillion. Individual reforms to specific expenditures, or more overarching limits on taxpayers' ability to claim them—such as capping the marginal tax rate for deductions—can be an important part of the solution.

Introducing a new tax base on consumption or carbon emissions: Economists tend to favor taxes on consumption, such as value-added tax (VAT), because it can incentivize additional saving, which is associated with higher rates of growth. Taxes on carbon emissions, such as a carbon tax or carbon border adjustments, are similarly favored because they discourage carbon emissions and can address the harmful economic consequences of climate change. Proposals to implement taxes on consumption or carbon emissions are often accompanied by refunding mechanisms, whereby some or all revenue raised is returned to taxpayers to offset the regressive nature of the taxes. However, to the extent that some or all the revenue raised is not refunded, introducing these taxes can have a meaningful impact on the budget outlook. For example, CBO estimated that a VAT on a narrow base of consumption (excluding items like health care, groceries, and new homes), would raise roughly $2 trillion over 2024 to 2032. Similarly, CBO estimated the fiscal impact of an excise

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[12] Congressional Budget Office, "Marginal Federal Tax Rates on Labor Income: 1962 to 2028," January 24, 2019, https://www.cbo.gov/publication/54911.

[13] A menu of Social Security reform options published by CBO in 2015 found that raising the payroll tax rate by 1 percentage point would reduce the 75-year actuarial deficit by 0.3 percentage points, which equates to just over 20 percent of 1.4 percent of GDP long-term gap estimated by the agency.

[14] Office of Management and Budget, "Table 2.3—Receipts by Source as Percentages of GDP: 1934–2028," *OMB Historical Tables*, n.d., https://www.whitehouse.gov/wp-content/uploads/2023/03/hist02z3_fy2024.xlsx.

[15] US Department of the Treasury, "General Explanations of the Administration's Fiscal Year 2024 Revenue Proposals," March 9, 2023, https://home.treasury.gov/system/files/131/General-Explanations-FY2024.pdf.

[16] Tax expenditures are legally defined as "revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability." Office of Management and Budget, "Analytical Perspectives: Budget of the U.S. Government Fiscal Year 2024," March 2023, https://www.whitehouse.gov/wp-content/uploads/2023/03/spec_fy2024.pdf.

tax on greenhouse gas emissions, finding that such a tax could raise roughly between $570 billion and $870 billion over the next decade.[17]

Increasing rates of legal immigration: Immigration reform can be a powerful force for both economic growth and an improved fiscal position. A wide body of economic literature has found that increased immigration can bolster innovation, lower the price of goods and services, increase the number of jobs, improve government finances, and, in some circumstances, raise wages. While the macroeconomic impact of immigration reform depends critically on the nature of the reform, an oft-cited analysis by CBO found that the Border Security, Economic Opportunity, and Immigration Modernization Act would raise GDP by 3.3 percent over the first ten years and by 5.4 percent over the second decade.[18]

In addition to raising the rates of economic growth, immigration can also lower federal budget deficits and improve the outlook for Social Security. The above-referenced CBO analysis also found that comprehensive immigration reform would lower federal budget deficits by roughly $200 billion over the first decade and $700 billion over the second decade—with the latter estimate equating to about 0.2 percent of GDP. On Social Security, increased immigration can have a dramatic impact on the program's long-run solvency. For example, the most recent Social Security Trustees report shows that roughly doubling the rate of legal immigration—from 829,000 to 1,683,000 annually—would reduce Social Security's 75-year actuarial balance by just over 20 percent.[19]

Slowing or reversing inflation in health care: The outsized role of health care in the federal budget means that growth in health costs has an outsized impact on future budget deficits. Limiting the rate of "excess cost growth"—essentially the difference between growth in health costs and GDP—can have profound impacts on the budget outlook. In 2014, along with economists Alan Auerbach and William Gale, I published a report showing that the public debt would balloon to over 180 percent of GDP by 2040 with 2.5 percent excess cost growth, but would fall short of 120 percent of GDP under a scenario where there was no excess cost growth.[20] As a result, large-scale health reforms which slow excess cost growth, such as the Affordable Care Act, should be seen as an important tool in addressing budget deficits. More-targeted reforms, such as an acceleration in the Medicare Prescription Drug Inflation Rebate Program, can similarly improve the fiscal position of major health programs.

Gradually changing the age at which Social Security benefits can be claimed: The ongoing extension in life expectancy—up by roughly eight years over the past half century—introduces

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[17] Congressional Budget Office, "Options for Reducing the Deficit, 2023 to 2032 Volume I: Larger Reductions," December 2022, https://www.cbo.gov/system/files/2022-12/58164-budget-options-large-effects.pdf.
[18] Congressional Budget Office, "Cost Estimate: S. 744 Border Security, Economic Opportunity, and Immigration Modernization Act," June 18, 2013, https://www.cbo.gov/system/files/113th-congress-2013-2014/costestimate/s744_0.pdf.
[19] Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds, "The 2023 Annual Report of The Board of Trustees of The Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds," March 31, 2023, https://www.ssa.gov/OACT/TR/2023/tr2023.pdf.
[20] Alan J. Auerbach, William G. Gale, and Benjamin H. Harris, "Federal Health Spending and the Budget Outlook: Some Alternative Scenarios," *Brookings Institution*, April 11, 2014, https://www.brookings.edu/wp-content/uploads/2016/06/federal_health_spending_budget_outlook_auerbach_gale_harris.pdf.

questions about whether delaying Social Security benefits should be regarded as a tool to improve the program's solvency. CBO's analyzed four potential options for raising the age at which Social Security benefits can be claimed: raising the Full Retirement Age (FRA) to 68, raising the FRA to 70, increasing the FRA by one month per birth year, and simultaneously increasing the FRA by Early Eligibility Age by one month per birth year.[21] These reforms, according to CBO, would decrease the 75-year shortfall by approximately 15 percent to 30 percent.[22] Naturally, given concerns around differential experiences with life expectancy trends, such reforms would ideally be accompanied by offsetting provisions for populations with stagnant or declining life expectancies.

[21] Congressional Budget Office, "Social Security Policy Options, 2015," December 2015, https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/reports/51011-SSOptions_OneCol-2.pdf.

[22] In its 2015 report, CBO estimated the present value of the 75-year gap as a percentage of GDP to be 1.4 percent. It estimated that raising the FRA to 68 would reduce the gap by 0.2 percent of GDP, and the other three reforms listed would reduce the gap by 0.4 percent of GDP.