Comments on Louise Sheiner "The Long-term Impact of Aging on the Federal Budget"

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Issues taken up

- Impact of population aging on the US federal budget and public debt
- Policies to be adopted to respond to aging and maintain fiscal & debt sustainability, and the analysis of the contribution of each policy to the debt/GDP ratio
- Timing of spending and tax adjustments and the desirable composition of such adjustments
- Policy implications of growing life-expectancy disparities by income & education

What the paper does (1)

- To show that population aging will raise spending on Social Security (public pension) and Medicare (health insurance for the aged) without any policy action
  - This will riase the federal debt/GDP ratio without limit, making the debt dynamics unsustainable
- To examine the impact of aging on the real interest rate and productivity growth
  - Will likely reduce the real interest rate
  - Will have uncertain impact on productivity growth

What the paper does (2)

- To show that productivity growth slowdown will raise the debt/GDP ratio through
  - A decline in tax revenue due to slower growth of income
  - An increase in spending on anti-poverty programs
- To identify policy responses and assess their impact
  - Raising the size of labor force (i.e., grater immigration and higher labor force participation [through delay of retirement, women's higher LFP, etc])
  - Cutting spending (on entitlement and discretionary)
  - Raising taxes

What the paper does (3): Exploring optimal response

- To examine the impact of policy action under different scenarios in terms of timing of action
  - Act today (reduce deficits) to stabilize the debt/GDP ratio at a low level (40%)
  - Wait for 20 years to take action to stabilize the debt/GDP ratio at a higher level (105%)
  - Finding: Benefits of acting sooner than later are small because of the low interest rate assumed
- To assess several spending programs to be cuts
  - Better to protect investment spending (infrastructure, social spending such as education and transfers to low income HHs) relative to consumption spending
  - Important policy implications of life-expectancy gaps

A very useful and informative paper

- Useful analysis for the US budget and with some implications for other countries
- Good insight from numerical simulations
- Sound and balanced conclusion:
  - There is no urgency to act now
  - But considering the risk of future increases in the interest rate, better to act sooner to contain the rise of the debt/GDP ratio
  - As changes to entitlements (Social Security and Medicare) take time to implement, better to start acting sooner with small adjustments to spending and taxes

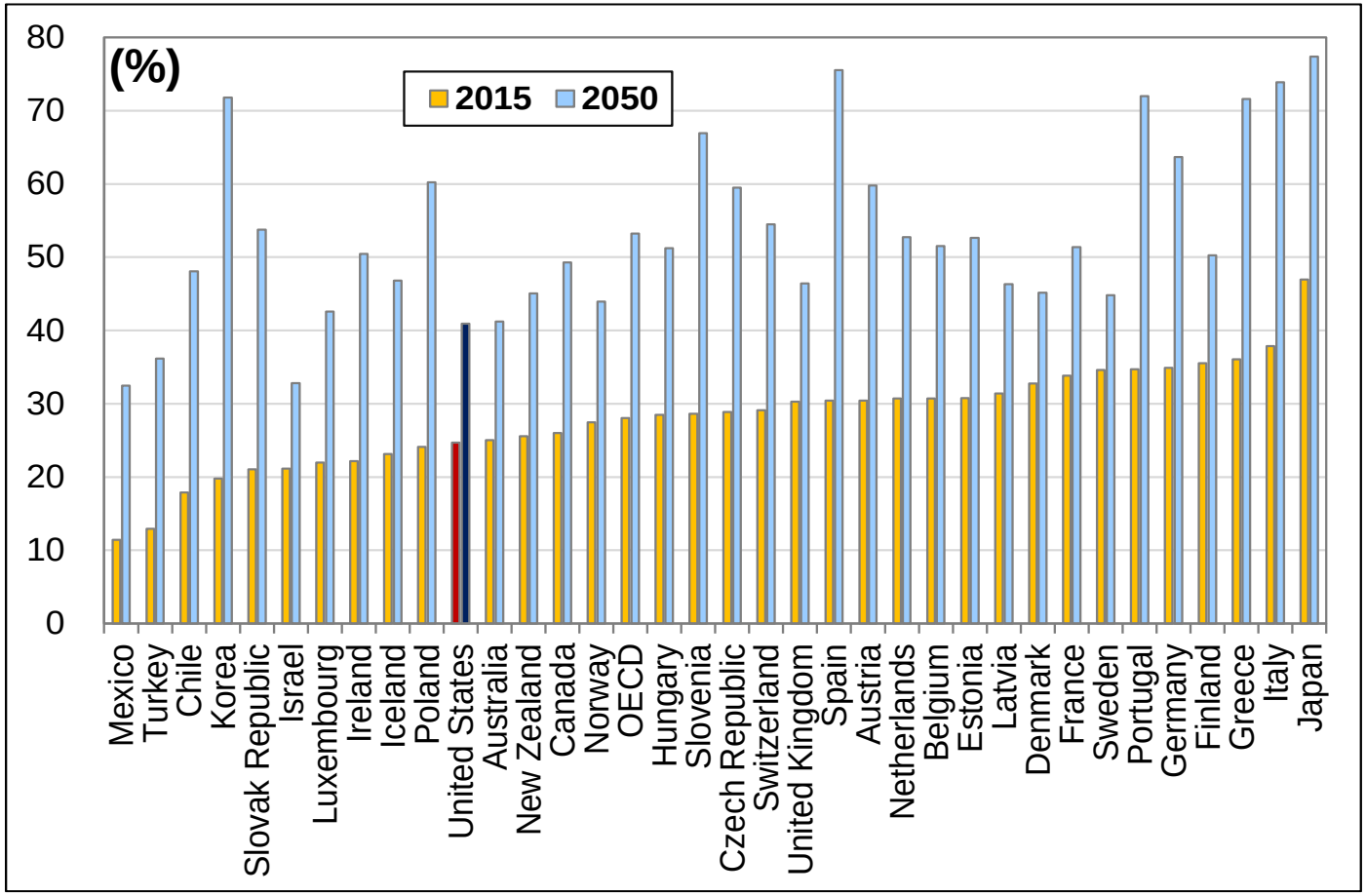
Several comments/questions

- Immediate policy action may not be needed in the US, perhaps because the US population aging problem is not so serious relative to other OECD countries
- The US has had a long period of budget deficits, but why is there no political voice to reduce the existing deficits?
  - Because the current deficits will not pose debt sustainability risks?
- Response policies
  - Raising productivity growth very important, but not considered in numerical simulations on LFP increases and benefits cuts
  - A more substantial delay of retirement such as 5 years may be considered
  - Concreate measures to raise women's LFP are not presented
- What does "optimal" policy response mean?
- What is the "sustainable" level of the debt/GDP ratio?
- Broader question: What are economic, social, and fiscal priorities for the US?

US aging pressure limited

- Population aging does not seem so serious in the US in comparison to other OECD countries
  - Old-age dependency ratio in the US in 2015 was relatively low among OECD countries
  - Its dependency ratio in 2050 is even less than Japan's dependency ratio of 2015
- Countries that face much larger aging pressure: Japan, Italy, Greece, Portugal, Germany, Spain, and the Republic of Korea

Old-age dependency ratio in OECD countries, 2015 & 2050

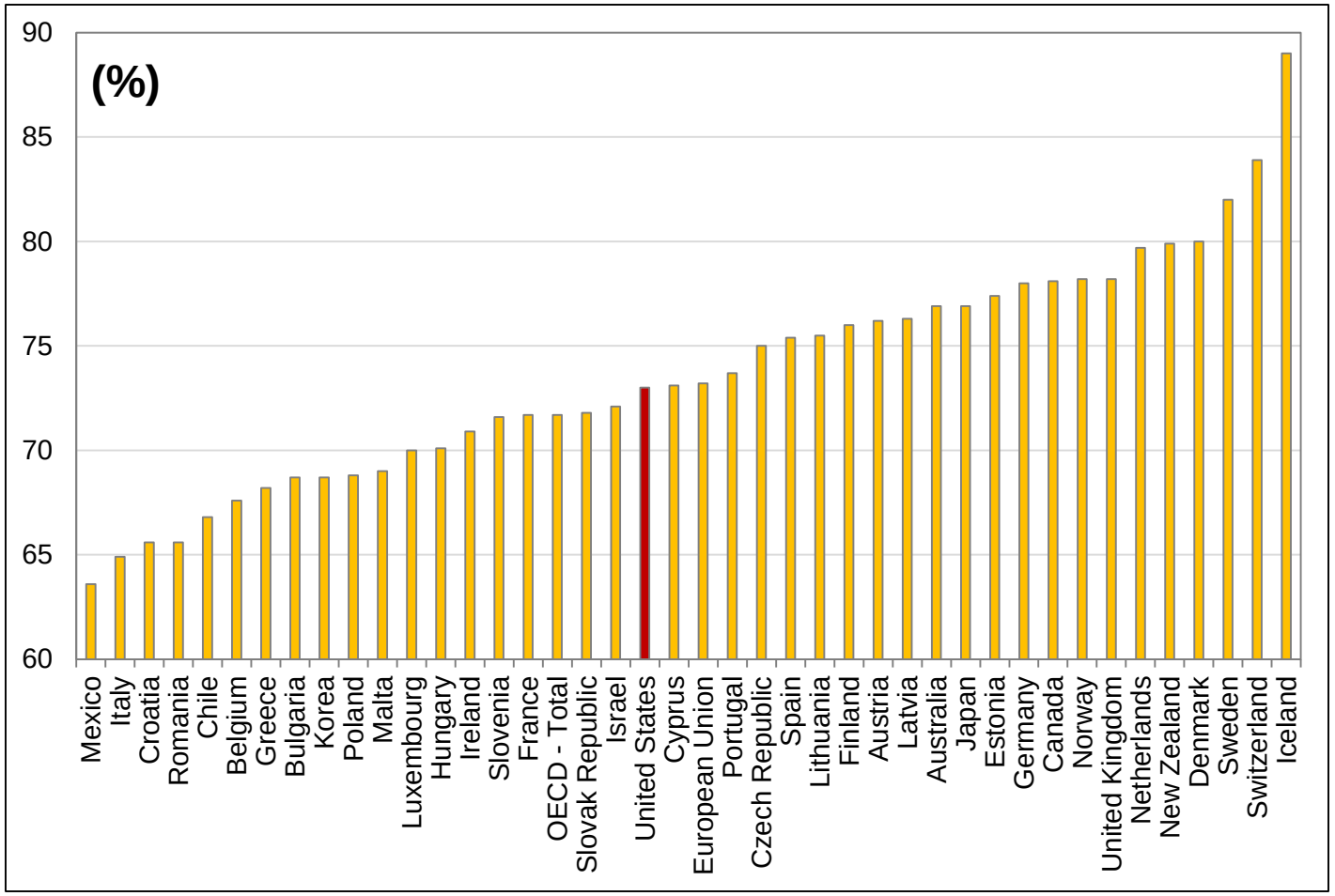


Source: Constructed from United Nations, *World Populations Prospects, 2015 Revisions*

Labor force participation rate

- LFP rate in the US is not particularly high and there is large room for the LFP rate to rise in the US
- Ways to increase LFP:
  - Extension of the retirement age
  - Increase of women's LFP

Labor market participation rate (age 15-64) in OECD countries, 2016

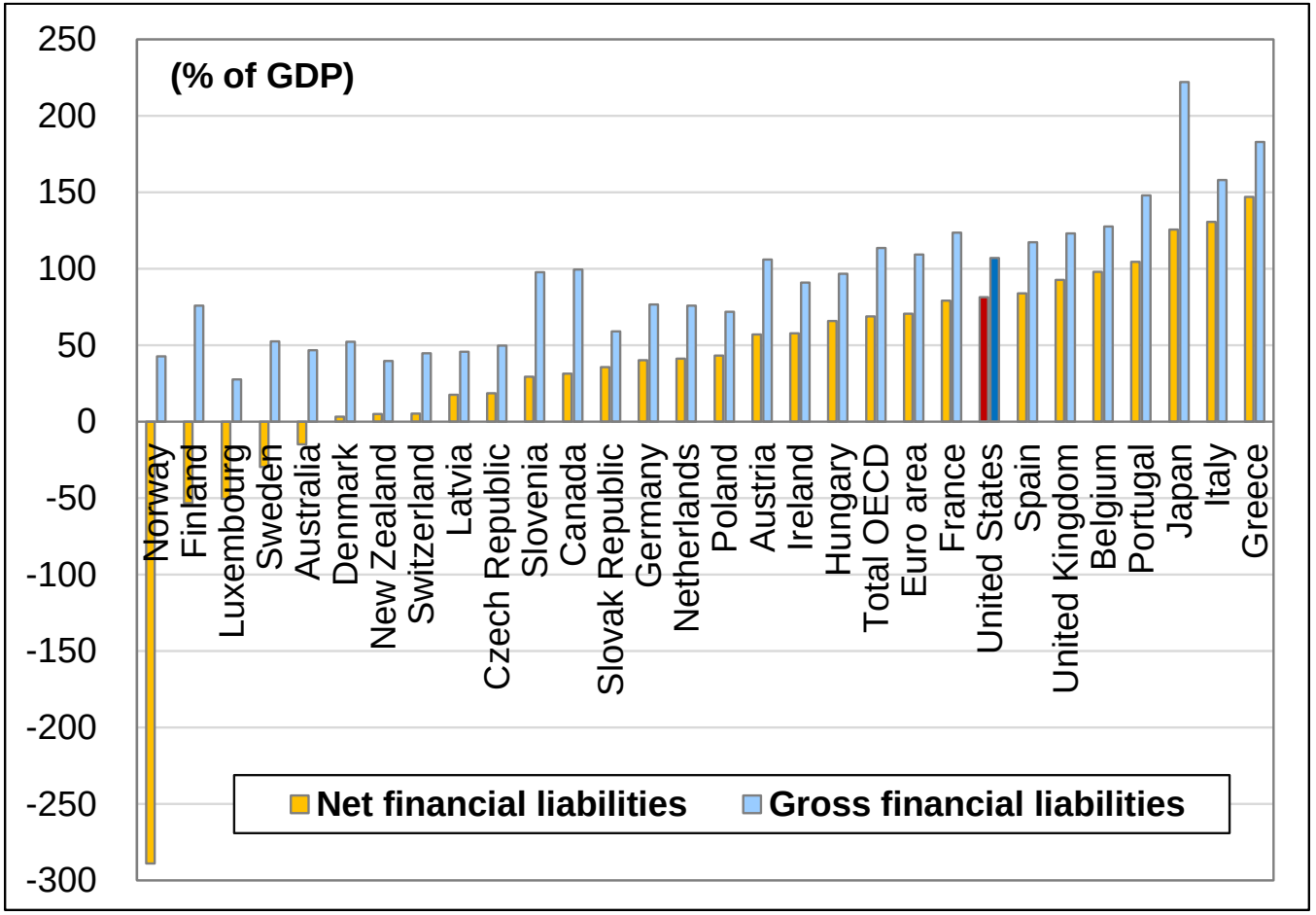


Source: OECD, *Preventing Ageing Unequality*, 2017

“Optimal” response and debt “sustainability”

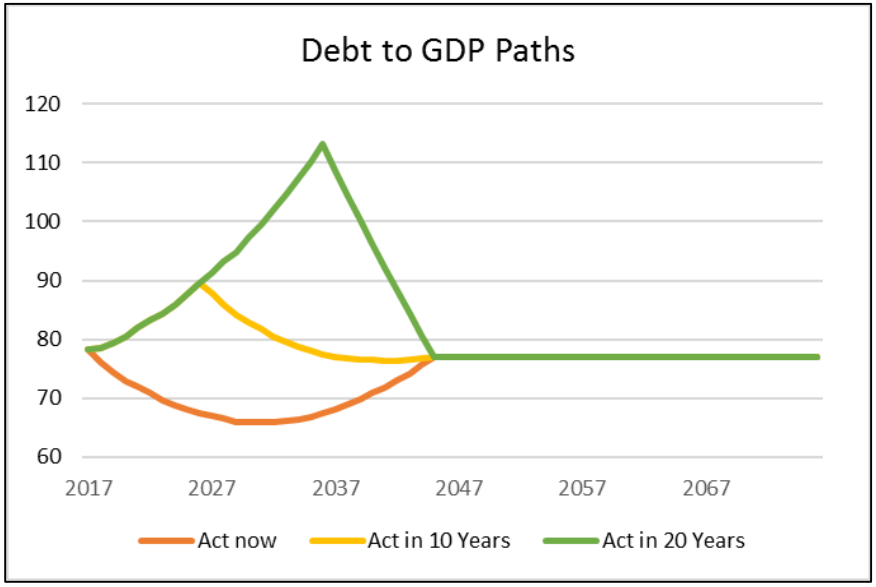
- How is “optimality” defined?
  - Based on social planner’s optimization?
  - Maximum welfare of consumers when achieving debt sustainability?
  - Least cost policy to achieve debt sustainability?
- “Sustainable” debt level
  - Avoiding the explosion of the debt/GDP dynamics
  - Achieving a reasonable debt/GDP ratio that is consistent with the ability to pay interest
  - Which level of debt/GDP ratio is reasonable, 40%, 77%, 105%, or 200% (as in the case of Japan)?
  - Debt should be measured in “net” rather than “gross” debt
- Some simulations suggest inefficient policy changes

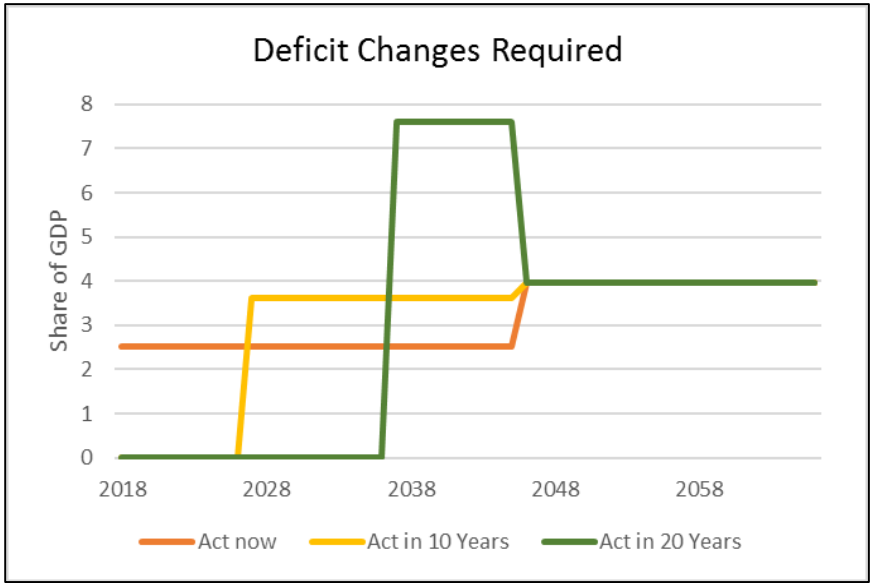
General government financial liabilities, gross and net (% of GDP), 2016



Source: OECD, *Economic Outlook*, June 2017

Fixing the debt/GDP ratio at 77% in 2047 and deficit reductions needed to achieve it





- Why should the government target the 77% level?
- What criteria should be used to choose among the “act now”, “act in 10 years” and “act in 20 years” policies?
- In the case of “act now” policy, why would the debt/GDP ratio decline first and then rise later? Some intuition is useful.

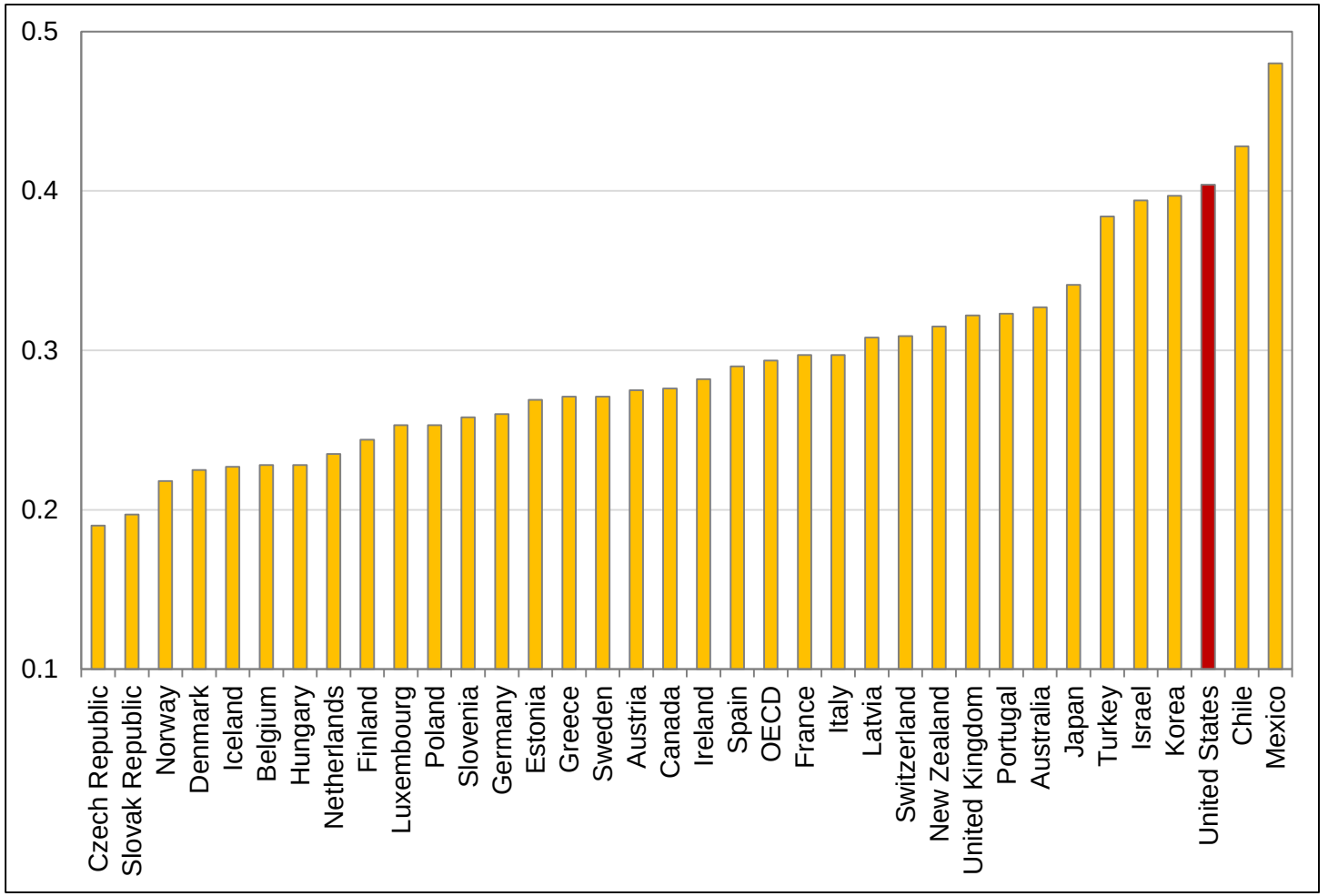
Suggestions for more simulations

- Identify the relative importance of key factors that lower the debt/GDP dynamics
  - Labor productivity growth
  - Larger size of labor force (increase in the fertility rate, labor force participation rate)
  - Cut in old-age related spending
  - Increase in tax revenues
  - Decrease in the interest rate
- Simulations under different combinations of these factors (with different values, such as high, medium, and low) would be VERY useful to get the sense of relative importance of each

Economic, social and fiscal priorities in the US

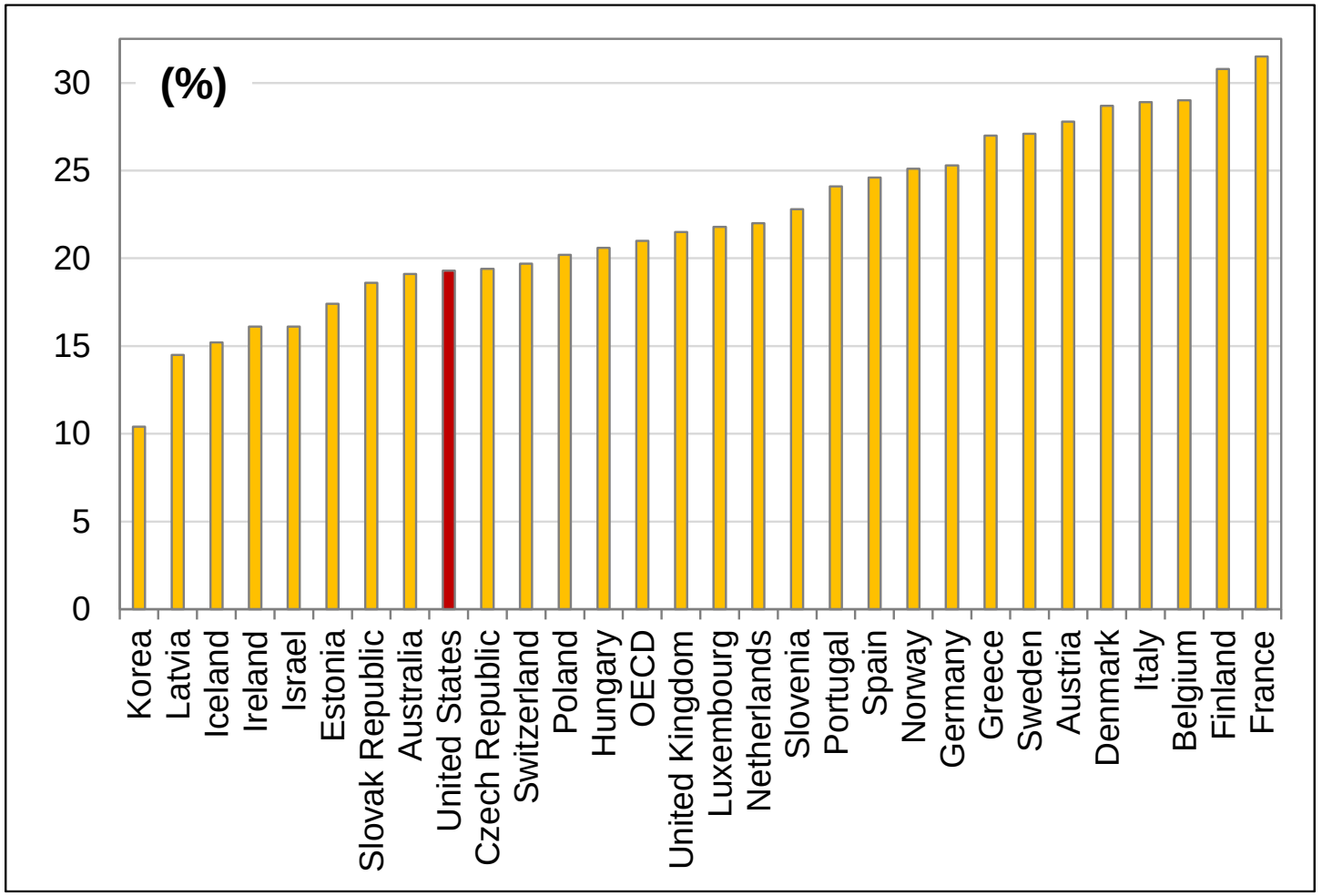
- One of the most important issues in the US:
  - Social division
  - Widening inequality
  - 99% vs. 1%
- Social sector protection spending in the US is relatively small among the OECD countries
- Addressing income inequality for today's young & working generations can have positive implications for the aging society
  - Inequality tends to persist over time
  - Investment in human capital (education, job training & re-training, health) very important
  - Investment to enhance labor productivity (including TFP growth) key to alleviate future aging pressures

Income inequality among elderly (65+), measured by GINI coefficient, 2014 or latest



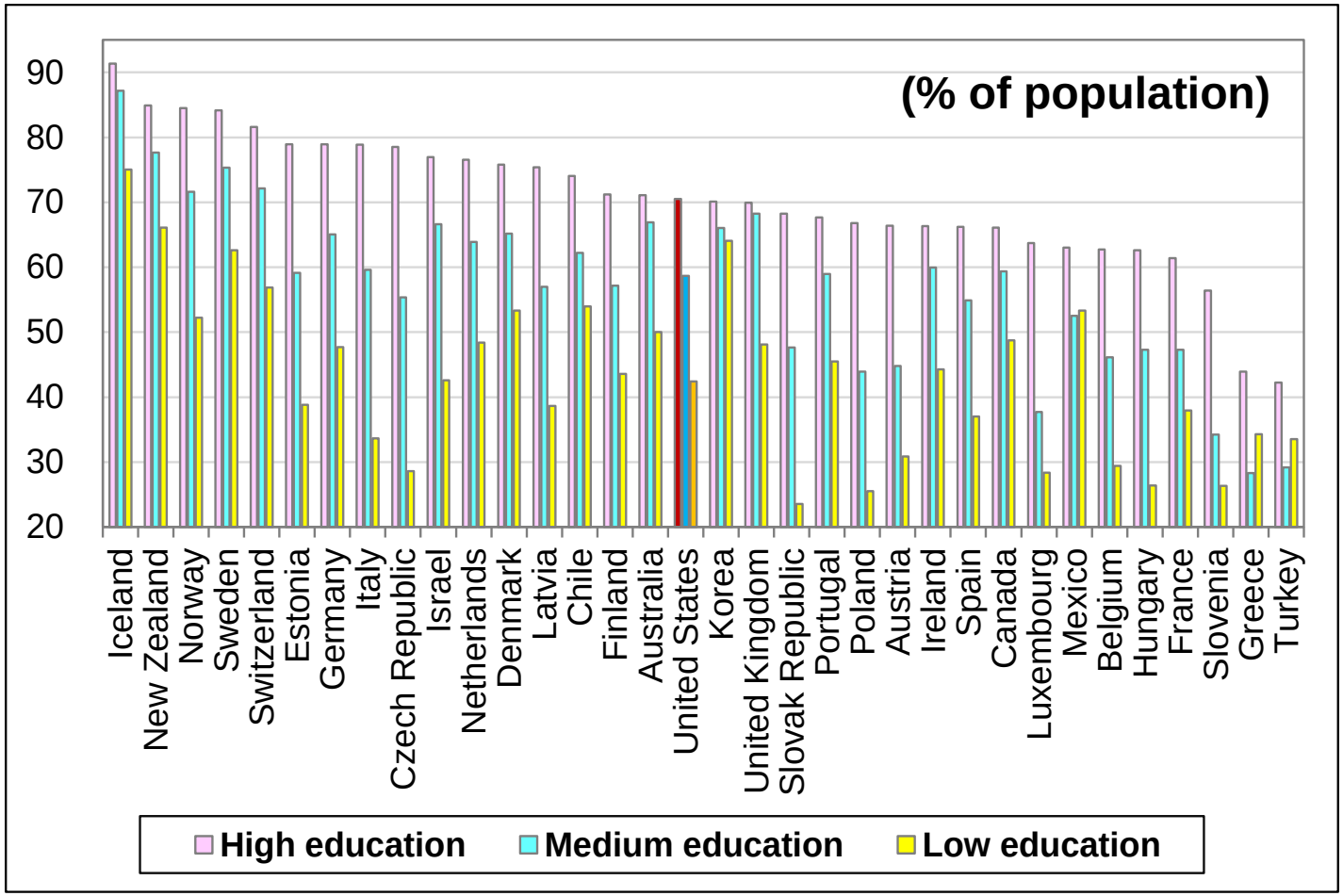
Source: OECD, *Preventing Ageing Unequality*, 2017

Social sector protection spending (% of GDP), 2016



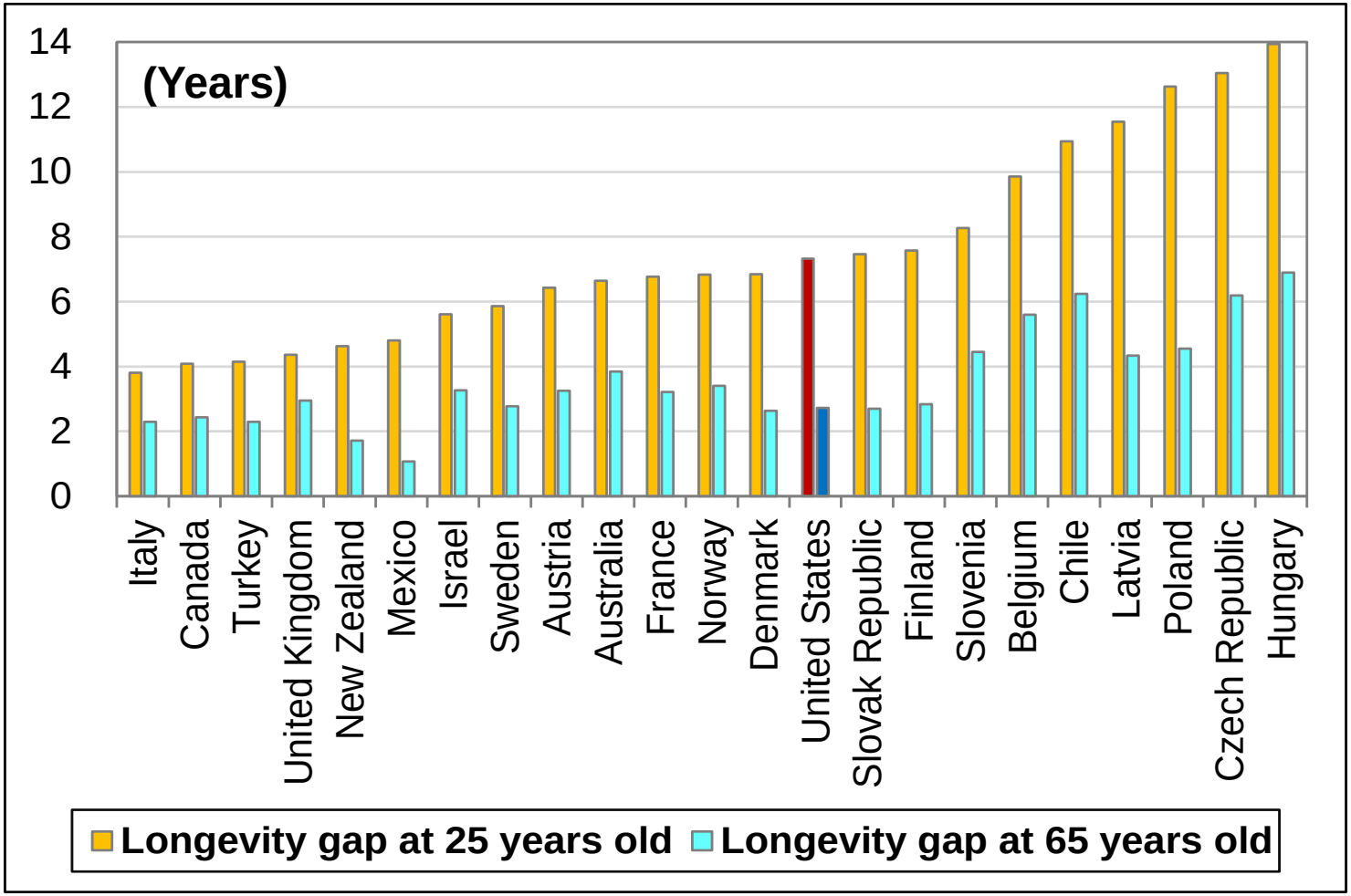
Source: OECD, website

Employment rate of semi-elderly (55-64) by education levels, 2015 or latest



Source: OECD, *Preventing Ageing Unequality*, 2017

Life-expectancy gaps between high- and low-educated people at age 25 & 65, 2011



Source: OECD, *Preventing Ageing Unequality*, 2017

Conclusion

- Very useful paper
- Paper could have clarified the concepts of “optimal” policy responses and “sustainable” levels of debt/GDP ratio
- Not only expanding the size of labor force but also raising labor productivity are key to respond to population aging
- Focusing on the inequality issue of the current generation may help avoid large burdens in the aging society

Thank you

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