POPULATION AGING, ENTITLEMENT GROWTH, AND THE ECONOMY

Demographic aging—the graying of the baby boomers, increasing longevity, and low fertility rates—is changing the age structure of the United States. Many experts say these changes will have an unsustainable impact on the federal budget by causing rapid growth in federal spending for health and retirement benefits for older Americans, especially for Social Security, Medicare, and Medicaid.

Demographic aging may also negatively affect the U.S. economy and American families. Low fertility rates will slow the growth in the labor force; fewer workers will be available to support an aging population. A slower-growing labor force will slow economic growth. If left unchecked, increased deficits and government debt will choke off investment and further stifle economic growth. The slowing of economic growth will mean stagnant wages and slower family income growth as well. Health costs, which have outstripped economic growth even in prosperous times, will continue to increase faster than family incomes.

Can we afford our aging society? Is our fiscal future as bleak as many experts claim? In this report, John Gist takes a long-term perspective on these questions, examining the historical experience with “entitlements” and projecting out to the middle of this century. Looking backward, entitlement spending has actually been remarkably stable as a percentage of gross domestic product (GDP) for the past two decades, with one exception—health care. By 2016, Social Security will still consume about the same share of the economy as it did when Ronald Reagan was first elected president. Eventually, Social Security’s costs will rise by two percent of GDP, but after 2030, when the last boomer has retired, Social Security will resume a gradual and manageable growth path. Other nonhealth entitlements will remain a smaller share of GDP than they were 40 years ago.

It is in health care only where entitlement growth presents serious future challenges. Rapid growth in health care costs is really nothing new, however. Overall health care costs, including Medicare and Medicaid, have risen faster than the economy for decades and are projected to do so indefinitely, with Medicare overtaking Social Security as the largest federal program within 20 years. However, contrary to much conventional wisdom, population aging is not the chief cause of this growth. An aging population accounts for only about one-sixth of Medicare’s growth since 1970.

Our long-term budgetary challenge is to maintain the integrity of the social insurance programs that provide health and income security for current and future retirees without sustaining economic ruin. Our ability to achieve that goal will depend chiefly on two factors: the growth rate of health care costs and the willingness of the populace to be taxed. A starting point for avoiding a future “train wreck” would be to maintain the same level of spending restraint in our health programs that we have already achieved in the past decade and refrain from enacting any additional tax cuts, allowing revenues to rise automatically. This would hold the primary deficit (revenues minus noninterest spending) to a level in 2050 no larger than it is today. Because debt would still be rising in this scenario, additional policy solutions would be needed. Reforms to the health care system, making Social Security solvent, introducing greater budget discipline, getting people to work longer and save more would allow us to provide economic and health security while achieving fiscal stability and sustaining long-term economic growth.