

Can Budget Offices Help Us Address Demographic Pressure?

As pressures mount on the nation's long-term budget, the Congressional Budget Office now views the aging of the population as the main stressor and health care costs as a close second. Yet, CBO and the Office of Management and Budget (OMB) have traditionally offered only limited analysis and estimates on addressing these demographic concerns, often leaving them to the Social Security Administration, which focuses only on the Social Security piece of the budget puzzle.

Accordingly, when groups like the president's budget commission meet, they get too few options on how government might adjust to the two distinct forces mistakenly put under a single "aging" banner: (1) longer lives and (2) fewer children (new workers) than previous generations. For better and often worse, reform groups frequently stack up reforms by their budget impact. But where there's no estimate, there's no political traction and, alas, no action.

If we want real budget reform, we need to get over this hurdle.

To start, we have to understand what puts it there in the first place. Put simply, we may soon see a fairly dramatic drop in the proportion of workers in the population and the taxes they pay, along with a commensurate increase in the number of people who depend on government for support. As baby boomers retire, this triple whammy on output, revenues, and spending intensifies.

The hit on government is most often discussed as a Social Security problem. That's misleading. The real, far bigger problem is fewer people producing less output and generating far less income for themselves. In turn, these individuals start saving less, spending down their savings sooner. When it comes to government, they start paying less income tax and start relying more on programs like Supplemental Security Income (SSI) and Medicaid—close to half of the latter's budget pays for long-term care. All these repercussions are in addition to any effect on Social Security taxes and benefits.

If policymakers could relieve some of this demographic pressure—particularly by avoiding some of the projected drop in employment rates among those in late middle age and older—then revenues rise without tax rate hikes, and those higher revenues support additional benefits at any tax rate. Such a win/win scenario should be easy for both Republicans and Democrats to embrace.

So what's stopping them? For one, the ingrained habit of raising this issue strictly as a Social Security problem even though the Social Security Trust Fund balance doesn't tell the whole story.

But there's another, more complicated reason. Budget offices seldom project changes in national output and income from reforms. Politicians assert that their every proposal promotes growth by helping people, improving incentives, or reducing deficits. As Congress drafts and redrafts bills, estimators don't have the ability—or the time—to rank every proposal by its impact on growth. Also, evaluating all legislation affecting the budget by very uncertain impacts on national income gives estimators too much power over issues that require a broader legislative debate.

In practice, there are exceptions. The Social Security actuaries do project some changes in long-term behavior when it affects Social Security. And unified budget projections (as opposed to cost projections of congressional bills) do incorporate some estimate of where the economy is headed.

Still, more generally, the budget impacts of a populace that works more and longer aren't going to emerge from traditional budget and Social Security analyses. A recent CBO report on Social Security reform options that affect Trust Fund balances, for instance, didn't touch on proposals to bump up the early retirement age or to backload benefits more to older ages. These proposals trade off fewer benefits in early retirement for more benefits in later retirement, but they generally don't help the Social Security Trust Fund balances unless they increase work effort. Thus, once CBO excluded

estimating behavioral shifts, as well as impacts on income tax revenues, it effectively excluded the proposals from the report. Such proposals, by the way, have another non-Trust Fund objective: improving protections for the frail by reorienting payments to when people are truly old.

As another example, a few years ago the CBO staff wisely decided to check out statements that budget problems were driven almost solely by health care cost growth. But even when the analysts provided credible measures of the relative budgetary effects of health cost growth, demographic shifts, and their interaction, they didn't venture to estimate the impact on general revenues of any projected drop in share of the population employed.

Of course, estimating these impacts is no piece of cake. Budget offices lean toward conservative estimation on grounds that large behavioral shifts, however frequent or powerful, are hard to predict. That's one reason budget offices have underestimated the cost of, say, Medicare as implemented or guarantees for Fannie Mae and Freddie Mac. But budget analysts often underestimate upside potentials of legislative actions as well.

My work with Brendan Cushing-Daniels, for instance, suggests that the signal government sets by fixing Social Security retirement ages significantly affects the decision of when to retire—independently of whether there are any real economic gains from retiring at those ages or later (see <http://www.urban.org/publications/412201.html>). But think about trying to estimate the ultimate effect of changing those signals amid demographic shifts unlike any the developed world has ever seen. (I'm emboldened a bit here because one of my past predictions is proving correct: Social Security underestimated the work efforts of older workers once earlier retirement was not so easily supported by baby boomers and women entering the workforce in droves.)

Since budgeteers have to live with some uncertainty, one key to successful reform is not to depend so much on estimates being right, but to set in place triggers that keep a system in balance as behavioral patterns shift. If reform increases work, for instance, then fewer other benefit cuts or tax increases would go into effect.

Such reform options won't even be considered as long as the budget offices can't improve ways to analyze and estimate proposals addressing these demographic shifts. But with looming deficits threatening to hamstring growth, opportunity, and the safety net itself, there's no longer much time to wait.

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