Fiscal Stresses & International Resolutions

Dr. Larry Kimbell
Former Director
UCLA Forecast

Presented at a Conference
Identifying Long-Term Problems and Their Solution
Economic Forecast Center
J. Mack Robinson College of Business
Georgia State University
Atlanta, Georgia
November 19, 2003
Recently I was reading the adjacent table from the U.S. Census website, showing the number of persons 85 and over, historically for the past 100 years, and projected forward until (surviving) baby boomers are 100. I asked myself:

What size industry will Boomer Care be by 2050?
United States Age Pyramid, 1965
Baby Boomers Born but not in Work Force
United States Age Pyramid, 2030
Baby Boomers Virtually All Retired
United States Age Pyramid, 2050
Most Baby Boomers Dead, Survivors 85+
Outline of Presentation

♦ Short-Term Fiscal Situation
♦ Two Long-Term Scenarios based on different rates of migration to the U.S.
♦ Why worry if deficits persist?
♦ Summary
Short-Term Fiscal Situation

♦ Federal deficit has gone from balanced to large deficits because of recession, slow recovery and the Bush tax cuts.

♦ State & local governments are in worse condition than in many decades.

♦ Faster economic recovery will moderate the deficits but will not eliminate fiscal stresses.

♦ (Adapted from EFC forecast to be presented by Rajeev later)
Two Long-Term Scenarios

1. The Consensus Migration Story
   - The almost universally accepted demographic foundation for long-term forecasts is that baby boomer retirements pose a substantial tax burden on future workers. I will begin with this story.

   - But what if migration supplies all the labor elderly boomers will need? Almost completely ignored is the distinct possibility that international migration will respond to the job opportunities created by boomer retirement and their health care needs.
The Consensus Migration Story

♦ Baby boomer retirements mean drastic increases in dependency ratios, with large tax increases for workers.
♦ Retirement costs and Medicare expenses will explode but tax payments will not keep pace, so deficits will be almost impossible to control.
♦ High deficits, unless offset, will crowd out private investment and make future generations poorer.
♦ This problem will ease only after 2050, when boomers are finally reduced to a few survivors approaching 100 years old.
The 65+ Elderly Dependency Ratio is defined as:

\[
\frac{\text{Population 65+}}{\text{Working age population (16-64)}}
\]

(And similarly for those 85+)
Dependency Ratio Projections under the Consensus Migration Story

We’re in the lull before the storm
Social Security Retirement Benefits
(Share of GDP)
## Average Health Care Expenditures by Age in 1999

<table>
<thead>
<tr>
<th>Age</th>
<th>Ann. Costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>65 - 69</td>
<td>$6,711</td>
</tr>
<tr>
<td>70 - 74</td>
<td>$8,099</td>
</tr>
<tr>
<td>75 - 79</td>
<td>$9,241</td>
</tr>
<tr>
<td>80 - 84</td>
<td>$10,683</td>
</tr>
<tr>
<td>85+</td>
<td>$16,596</td>
</tr>
</tbody>
</table>

Data include out-of-pocket and insurance covered expenditures.
Medicare Expenditures
Share of GDP
Who will care for 24 million old boomers?

♦ Not me. I’ll be long gone.
♦ 3 of my 6 children *ARE* baby boomers.
♦ The other 3 of my children don’t want to carry bed pans for their older siblings.
♦ What size industry are we talking about?
♦ How many custodial and low-paying health care jobs will be created by Boomer Care?
Some arithmetic on the Boomer Care Industry

♦ By 2050 there will be 24 million people living in America over the age of 85.

♦ Recently, this group spent $16,596 per person per year on health care (out-of-pocket and mostly Medicare).

♦ Total living expenses averaged $25,000 per person.

♦ I estimate Boomers will spend
  – $1 Trillion 1996 Dollars per Year in 2050
  – Supporting 100 million workers @ $10,000 per job.
  – With dependents, we need 200 million more people.
Two Population Scenarios

♦ 282.8 million = Current U.S. Population

♦ 414.7 million = Consensus Projection
  Growth is 0.8% annually.

♦ 600.1 million = Market Driven Proj.
  Growth is 1.5% annually.
Two U.S. Total Population Projections

Consensus Projections Ignore Boomer Care Opportunities
My Alternative Projection Assumes Markets Work, Help Will Come!
(Millions of Persons)

If you believe markets work, then boomer needs can be met by international migration.
Other ways to keep social security solvent

♦ Work boomers until they are dead.
♦ Send them to China for retirement.
♦ Ration medical care.
♦ Raise taxes on the incomes of foreigners living abroad (the only HAPPY SOLUTION!)
Rationing medical care will be very tough

♦ My friend died recently after battling cancer for 18 years. The last 90 days of his life were spent in the intensive care ward, often unaware of his circumstances. The cost of this final episode was $500,000.

♦ My 90 year old aunt died weighing 69 pounds. She had an operation on Monday and died Friday.

♦ I’m glad I didn’t have to help make these decisions. Our medical system needs to acquire the discipline to provide painless, caring hospice care.
*Raise taxes on incomes of foreigners living abroad*

- Tax imported luxury automobiles $10,000 per car. Who pays?
- Tax incidence theory says it depends on elasticities of supply and demand, here and abroad. An example:
  - $3000 higher U.S. imported car prices
  - $1000 lower incomes of U.S. imported car dealers & their workers.
  - $5000 lower incomes of Japanese auto workers
  - $1000 Japanese auto company profits.
- Risk in this strategy? Retaliation by Japan.
Why worry about deficits?

♦ We can always inflate our way out. That is, print enough new money to “pay off” the debt.

♦ Large federal deficits can be offset by:
  – High personal saving (not our current inclination)
  – State & local gov’t surpluses (merely shifts the cost cutting burden)
  – High foreign investment (will we repudiate their claims?)

♦ Otherwise, large federal deficits mean crowding out of private investment, and smaller capital bequests to future generations.

♦ Do we really plan “… to eat the seed-corn” of the next generation?
Of course we plan to leave deficit reduction to the next generation

Larry Kotlikoff (leading expert on inter-generational economics) says:

“Deficits really matter, but not for the first 30 years.”
Summary: those of you 10 years younger than me should worry about deficits.

Hasta la vista, baby-boomers!