Population Aging and Tax Policy

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Notes for the slides can be found at the end of the presentation.
How should policymakers change tax systems given population aging and its economic effects?

[a particularly relevant question given heightened attention to tax reform]
Population aging is increasing dependency ratios

Population 65+ Relative to Working-Age Population

Population aging has contributed to lower interest rates

Gagnon et al 2016 argues that demographics account for 1.25pp of the decline in the equilibrium real interest rate since 1980.

U.S. Interest Rates

Source: Federal Reserve Board.
Population aging *might* have lowered productivity

Some studies (e.g. Feyrer, 2007) suggest productivity is highest for the 40-49 age group.

But, *note that any such effects are now behind us.*

Another channel is that older households do more consuming from lower-productivity sectors.
Objectives of tax policy

Collect revenue to finance government services and benefits

Incentivize saving and work

Mitigate business cycle fluctuations

Improve resource allocation in other ways (e.g. correct for externalities or other distortions)

Redistribute income
Population aging is contributing to a significant worsening of the budget situation—even accounting for lower interest rates.

So we are going to need more tax revenues (spending cuts too).
Incentivizing saving and work

Population aging heightens the need to encourage retirement saving given difficulties many people have saving.

Behavioral literature (e.g. Chetty et al, 2014) => most important way to change tax policy is to provide more incentives for firms to set up plans.

Budget strains associated with population aging mean addressing the downtrend in working-age labor force participation is even more important.

So tax incentives for work should be increased, with focus on groups with the most elastic labor supply (child care subsidies to encourage second earners, EITC expansion to encourage less-skilled men).
Mitigating business cycle fluctuations

Lower real interest rates mean central banks will hit the effective lower bound more frequently (see, for example, Kiley and Roberts, 2017).

**Monetary policy less potent** as a countercyclical force.

So need **stronger automatic stabilizers** in the tax system.

E.g. automatic adjustments in payroll tax rates when the unemployment rate crosses a given threshold (coupled with automatic general revenue contributions to Social Security to make up for the foregone revenue).
Improving resource allocation in other ways

IMF research suggests distortions in tax systems weigh significantly on productivity.

Coming fiscal strains from population aging, coupled with global decline in productivity growth, make removing distortions and correcting for spillovers / externalities an even higher priority.

Source: International Monetary Fund.
Redistributing income

[Obviously] more transfers to the older population because of population aging.

Other implications less clear:

Less potent monetary policy might argue for stronger safety net programs.

Greater need to enhance productivity might argue for more transfers to families with children that have been demonstrated to lift the adult earnings of the children.

But need to think about traditional efficiency trade-offs associated with more redistribution.
## Summary

<table>
<thead>
<tr>
<th>Tax policy objective</th>
<th>Implication of population aging</th>
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<tbody>
<tr>
<td>Collecting revenue</td>
<td>Will need to collect more revenue</td>
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<tr>
<td>Incentivizing saving and work</td>
<td>More subsidies for saving needed</td>
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<td></td>
<td>More incentives for work needed</td>
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<td>Mitigating business cycles</td>
<td>More automatic stabilizers needed</td>
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<td>Improving resource allocation</td>
<td>More important than ever</td>
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<tr>
<td>Redistributing income</td>
<td>No strong argument for increasing redistribution broadly but maybe</td>
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<td>selective steps</td>
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</table>
Endnotes

Slide 2: Data source—World Bank. Working-age population includes people 15-64 years old.


Slide 6: Data source—Congressional Budget Office. The long-term budget projections were last updated in March 2017 and can be found in a spreadsheet here.

