New Census data has worrisome fiscal implications

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The Census Bureau reported on Dec. 20 that America's population grew 0.7 percent from July 1, 2015 to July 1, 2016 — the slowest rate of increase since the Great Depression. In some sense, this is neither good news nor bad news, just a reflection of demographic trends.

But demographic trends can have big implications. As a general rule, businesses like the idea of more people for the simple reason that they will have more customers.

An expanding population is particularly important for certain sectors of the economy, such as housing. So there is a general assumption that a nation with a growing population will have more economic output.

Though, what presumably matters most is not total economic output, but rather per-capita output. People sometimes get agitated, for instance, that China's gross domestic product (GDP) eventually may exceed GDP in the United States.
Perhaps that's not good news for geopolitical reasons, but that's not a reason to trade places if we care about living standards. After all, per-capita economic output in China is only about one-fourth of what it is in America and that's assuming that Chinese economic numbers can be trusted.

That being stated, there is a big reason to worry about the slowdown in population growth in the U.S. Many of our entitlement programs were created based on the assumption that we would always have an expanding population, as represented by a population pyramid.

In other words, a relatively small group of old people, a large number of working-age people, and then an even bigger cohort of children. And with that demographic profile, a modest-sized welfare state (mostly based on redistribution from workers to retirees) is mathematically feasible.

Over time, however, we've seen major changes in demographic trends, including longer lifespans and falling birthrates. The combination of these two factors means that our population pyramid is slowly, but surely, turning into a population cylinder.

This has very painful implications for fiscal policy. In the absence of structural entitlement reform, this looming shift in America's population profile means massive amounts of red ink as the baby boom generation moves into full retirement.

This implies either big tax increases or significant budget cuts. Not because politicians actually want those changes, but simply because there will be too many beneficiaries and too few taxpayers.

This isn't empty theorizing. The Congressional Budget Office's long-run fiscal forecast, which is based on current law (meaning not only no structural reform, but also no tax hikes or spending cuts), shows burgeoning levels of government debt.

The long-run fiscal outlook for the U.S. is also very grim if you look at the forecasts from international bureaucracies, such as the Bank for International Settlements, Organization for Economic Cooperation and Development, and International Monetary Fund.

Indeed, these international bureaucracies project that the U.S. will have more red ink than Europe's decrepit welfare states.

For what it's worth, I don't actually think the fiscal outlook for the U.S. is worse than it is for countries like Italy and France. The international bureaucracies assume that policymakers won't act, so their models show that we'll have European levels of government spending within a couple of decades while keeping our tax burden at current levels. That would mean ever-larger deficits and compounding levels of debt.

That could happen, of course, but it's also possible that Washington will get serious about genuine entitlement reform. For instance, if Congress adopted the structural reforms that have been in House budgets in recent years, much of our long-run spending problem would disappear.

Given the built-in changes in our demographic profile, the real goal is to make sure that government spending grows slower than the private sector. This will protect the U.S. from either the no-growth economic anemia found in places like Japan, or the fiscal chaos and disarray of nations such as Greece.

But, a slowly growing population isn't just a challenge for the nation's long-run fiscal outlook. If you closely review the numbers from the Census Bureau, it becomes increasingly apparent that there are some very uncompetitive, high-tax states, such as Illinois, that are in deep trouble due to internal migration.

Most people have focused on the overall population loss of 37,508 in Illinois, but the number that should worry state politicians is, on net, a staggering 114,144 people left for other states.

Only New York (another high-tax state with a grim future) lost more people to internal migration.

Of course, what really matters, at least from a fiscal perspective, is the type of person who leaves. Data from the internal revenue service shows that states like Illinois are losing people with above-average incomes. In other words, the net taxpayers are escaping.

Moreover, when you then look at state-by-state data for unfunded liabilities — state employee retirement and health benefits — many of the same high-tax states that are losing taxpayers and taxable income also are on the hook to pay out lots of money in the future.

Needless to say, all of this is a recipe for budgetary disaster.

The situation isn't theoretically hopeless, however. Just like the federal government, the states also can dig their way out of their respective messes by restraining the growth of spending.

The problem is that there do not seem to be any politicians in states such as Illinois that have a serious approach to long-term fiscal issues.

The bottom line is that population changes are inexorably creating a fiscal crisis for the federal government and many state governments.

The good news is that there's still a lot of time to adopt the reforms that are needed to restrain spending and avert a big mess. The bad news is that politicians rarely address problems ahead of time.

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