

The coming generational storm essay sample



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While our nation's aging may not change our government's objectives, the aging process may wreak havoc on traditional measures of fiscal policy. If more appropriate measures are not developed, all this will lead to a misreading and misdirection of fiscal policy. The U. S. deficit is a case in point. In the next two decades the U. S. is projected to run significant surpluses arising, in the main, from an influx of social security receipts. What is needed as an alternative to the arbitrary deficits is a generational description of fiscal policy. The main point of the book *The Coming Generational Storm: What You Need to Know about America's Economic Future* by Laurence Kotlikoff and Scott Burns is the issue of generational accounting, a model developed by Kotlikoff and his long-time collaborators Alan Auerbach and Jagadeesh Gokhale. The current accounts, arbitrary as they may be, do not provide adequate information on how the government allocates its resources and how it affects today's economy. The fact that the classification is consistent over time does allow generational accounting system to provide meaningful information on trends. Unlike the deficit, which entirely ignores the future, generational accounting requires one to make a variety of assumptions about future economic and fiscal variables.

As Kotlikoff and others point out, much of the improvement in the relative income position of the elderly reflects an increase in social security benefits. Increasing transfers to the elderly by increasing the burden on future generations will reduce national saving. The result is "if our government continues on the course it has set, we will see sky rocketing tax rates, drastically lower retirement and health benefits, high inflation, a rapidly depreciating dollar, unemployment, and political instability." Even if these

transfers are from younger generations currently alive, the effect will likely be a decline in national saving. The life cycle hypothesis suggests that the elderly have higher marginal propensities to consume than the young, and some recent evidence confirms this.

Laurence Kotlikoff has attempted to reshape the deficit. His work has both a destructive and a constructive side. The former involves attacking the budget deficit as an outdated, misleading, and fundamentally noneconomic measure of fiscal policy that should be discarded. On the constructive side, he proposes replacing it with a new fiscal policy measure that he developed in collaboration with Alan Auerbach and Jagadeesh Gokhale. The model is called generational accounting - the direct description of the government's treatment of current and prospective generations over their lifetimes.

In rejecting the budget deficit as a measure, Kotlikoff expresses neither hesitation, qualification, nor nuance. He considers it not merely incomplete or potentially misleading but entirely meaningless. Kotlikoff views a focus on the budget deficit as misleading economists no less than politicians. A noneconomic measure cannot be expected to correlate with any of the ills for which it is commonly blamed, such as inflation, trade deficits, and reduced national saving. While Kotlikoff argues that the data in fact show no historical correlation, he supports this conclusion mainly on theoretical grounds. He makes much of the sheer number of commonly cited measures - such as the unified, Gramm-Rudman-Hollings, NIPA, and full-employment deficits, along with Eisner's variants-any of which economists in search of correlation can use. In the end, however, he relies mainly on what he considers the deficit's two fatal design flaws under all variants.

Generational accounting attempts to measure who, as between members of different age groups, pays taxes and gets benefits. By providing generation-specific breakdowns, generational accounting offers information that even an economic accrual measure of the budget deficit, with its statement merely of an aggregate number, cannot. For multiple purposes, therefore, generational accounting has the potential to be a major step forward. It provides data bearing directly on fiscal policy's impact on both generational distribution and current consumers' perceived wealth (assuming rational expectations on a lifetime basis). In addition, it helps in evaluating whether current fiscal policy is likely to be sustainable over the long term. Even on size-of-government issues, which Kotlikoff generally ignores, one could argue that shifting tax burdens from present to future generations is the real phenomenon.

Over time, Kotlikoff generally assumes, discretionary outlays will remain constant relative to GDP. Thus, higher economic growth has little systematic effect on the long-term adequacy of existing taxes to pay for projected spending. Instead, it comparably increases both sides of the ledger. If one assumed instead that discretionary spending would remain more constant in real terms, increasing to keep pace only with inflation and perhaps population growth, while tax revenues grew automatically with the economy, productivity-fueled economic growth would greatly increase the long-term adequacy of existing taxes to pay for projected spending under current policy.

The general assumption that “current policy” will continue indefinitely is subject to one important exception, Kotlikoff notes. Generational accounting

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applies an intertemporal budget constraint, under which the sum of generational accounts of all current and future generations plus existing government net wealth [must] be sufficient to finance the present value of current and future government consumption. In short, government net wealth aside, total revenue must ultimately equal total expenditure in present value terms. Any long-term shortfall under current policy is assumed to require additional tax payments that will come exclusively from future generations. The deficit and national debt must ultimately be reduced to zero, but our unborn descendants, not we, will pay for this in full to the extent that current policy fails to accomplish it.

An inherent problem with fiscal forecasting concerns the extent to which one should take into account the broader dynamic effects of proposed policies, such as on societal levels of consumption and investment. Government revenue estimators often are criticized for applying too static an analysis, by, for example, ignoring the effects on economic growth that adherents of a tax incentive for investment claim their proposal would have. The estimators defend their position on the ground that while some types of dynamic behavioral response can be assumed, other responses are too speculative and should be ignored.

As practiced by Kotlikoff, generational accounting disregards broader dynamic effects. It looks at government fiscal policy only in a global or aggregate sense, ignoring the possible generational significance of the details of the particular taxing and spending programs that the government adopts. Consider, for example, the claim that an income tax, by taxing some of the economic return to investment but none of the psychic return to

immediate consumption, discourages saving and reduces its amount, whereas a consumption tax generally is neutral with respect to when one consumes. This suggests that income taxation, by reason of its effect on private saving, may be worse for future generations than consumption taxation, even if the two alternative systems would generate equal revenues from current taxpayers. Or consider the argument that estate taxation greatly increases consumption by present generations and discourages leaving large bequests. Generational accounting not only makes no adjustment for the possible behavioral effects of such taxes (holding who pays them constant) but might mistakenly treat as benefiting future generations an income or estate tax increase that, on balance, reduced national saving to their detriment.

Yet Kotlikoff does not merely argue that generational accounting provides a better measure than the budget deficit. He argues that the latter measure is utterly meaningless and should be discarded for all purposes. Here he exaggerates. The deficit is neither so devoid of economic content nor so worthless as a fiscal policy guidepost as he maintains. An initial point is that cash flow can matter for some purposes. It is not theoretically impossible for the level of current U. S. government borrowing to affect interest rates.

The long-term financing problems presented by Social Security and Medicare may be more politically tractable when they receive distinct treatment. Long-term fiscal estimates for these programs have already attracted significant attention and motivated major policy changes. Indeed, the programs' popularity is such that emphasizing their expected long-term inability to pay

for themselves may be essential to persuading politicians and voters to consider fiscally necessary changes to them sooner rather than later.

Generational accounting considers pension spending in the context of public spending generally. Kotlikoff argues that government should promote ‘generational equity’, and should therefore seek to equalize tax burdens across generations. This objective is contentious. First, it is a value judgment and so, like all value judgments, is disputable. Secondly, a range of exogenous inequities—wars, natural disasters, major epidemics, the Great Depression, the collapse of communism—have generation-specific effects. It is by no means clear that equalizing tax burdens is the equitable solution. Thirdly, a definition of equity based on generations rather than individuals opens an ambiguity; with generations of varying sizes, equal treatment of generations by definition means unequal treatment of individuals, and vice versa.

In the book, Laurence Kotlikoff and Scott Burns analyzed the flow of government benefits to different generations, compared with the relative lifetime tax burdens of those generations. Their conclusion: older Americans today receive far more in government benefits than they ever paid in taxes. Moving down the generational ladder, however, the pattern shifts. The younger you are, the more taxes that government is likely to take from you over your lifetime. The less, proportionally, you can expect to receive in return. If society’s notion of generational equity entails extracting an equal proportional sacrifice from each generation, these numbers are highly discomfoting. They reveal a U. S. generational policy that will burden

today's children much more than today's adults. Tomorrow's children, meanwhile, are likely to be burdened even more.

References

Kotlikoff, Laurence j., and Scott Burns. (2004). *The Coming Generational Storm: What You Need to Know about America's Economic Future* . Cambridge: MIT Press.