Research Roundup

By Kerry Pechter *Thu, Jul 29, 2021*

We bring you summaries of two papers on the federal debt (and why low interest rates don't justify more of it), an essay on why Biden's infrastructure spending plan shouldn't need budget offsets, a paper on how Social Security treats stay-at-home moms, and an analysis of how people respond to sudden wealth.

Here's economist Larry Kotlikoff's scary argument: Today's low yields (and high prices) on government securities reflect investors' flight to safety—but the flight is driven less by confidence in Uncle Sam's financial strength than by the existential uncertainty that the government's rising debt load creates.

Ergo, the government shouldn't use its current low borrowing costs as an excuse or rationale to keep borrowing, Kotlikoff claims. More public debt will make investors more anxious, scare them into buying more Treasury debt, and extend a vicious cycle.

This is the paradox or irony concocted by the Boston University professor—who ran for president of the US in 2016 and likes to call Social Security a Ponzi scheme—in two June 2021 papers, "Deficit Follies" and "When Interest Rates Go Low, Should Public Debt Go High?"

"Uncertainty about the resolution of government debt policies can, itself, lower the government's borrowing rate, making deficits look cheaper precisely when they are becoming economically more expensive," he and his three co-authors write.

In this edition of *RIJ*'s Research Roundup, we summarize these and three other recent articles and working papers by US economic analysts. These include an evaluation of President's Biden's plan to repair America's infrastructure; a study of American reactions to financial windfalls; and a research brief from Boston College on the extent to which Social Security penalizes motherhood.

"Deficit Follies," by Johannes Brumm, Xiangyu Feng and Laurence J. Kotlikoff. (NBER Working Paper 28952), and "When Interest Rates Go Low, Should Public Debt Go High?" (NBER Working Paper 28951).

In these two papers, Kotlikoff and his co-authors dispute French economist Olivier J.

Blanchard's controversial suggestion that a government can borrow-and-spend without much harm if the interest rate on its debt is lower than its economy's growth rate.

Here's what Blanchard wrote in 2019: "If the future is like the past, this implies that debt rollovers, that is the issuance of debt without a later increase in taxes may well be feasible. Put bluntly, public debt may have no fiscal cost," Blanchard wrote in "Public Debt and Low Interest Rates." (**NBER Working Paper 25621)**.

Kotlikoff et al. attack that idea from three directions. The first involves the supposed paradox of deficit spending, noted above: Deficit spending creates investor anxiety, but investors don't shun government debt. Instead, they buy more, driving prices up and yields down. Perversely, that encourages more Treasury sales, more public debt, and more anxiety.

"Political and economic risks are causing people to be so scared that they're bidding up safe assets," Kotlikoff told *RIJ* recently. "It doesn't follow that you should take from the young to give to the old. You should understand the risk and fix it. That would argue for progressive taxation from winners to losers. The safe rate then goes back to the rate of return on capital."

His second point is that the government's liability for future Social Security benefits effectively adds tens of trillions of dollars to the existing long-term federal debt.

"With Social Security, you're taking from young people and, promising to give them benefits in future. With government bonds, you're taking the money and promising interest in the future," he said in our interview. "It's just different labels for the same thing. The government is generating uncertainty over which generation is going to be on the hook to resolve these unsustainable policies."

Kotlikoff's third message is that deficit spending beggars future American workers. "I think we have a history of taking from the young and giving to the old, to the point where we're endangering the economic welfare of the young. We should have been taking taxes from people, we should not have been using a deficit-expense response.

"My kids and all the other kids will have to pay. And if we don't tax ourselves to pay for the victims, then we leave the debt to our kids and we [the older generation] will end up having to consume more. The [cost of Social Security] should have been kept within a generation [not transferred across generations]."

Instead, these researchers conclude, the US should abandon the “pay-as-you-go” financing (which the paper calls “take-go”) method that it currently uses and let each generation pay, via taxes, for its own future retirement benefits. “Relative to running the risk-sharing policy, either immediately or down the road, engaging in take-go is a government-organized Ponzi scheme—making early participants better off and inducing future cohorts to participate in what is a hard-to-discern bad deal to recoup their investment.”

“Can Biden Build Back Better? Yes, If He Abandons Fiscal ‘Pay Fors.’” Levy Institute Policy Brief No. 155, June 2021.

Fifty years ago, the economist Abba Lerner favored “functional finance” over “sound finance.” Sound finance meant aiming for a balanced budget at the federal level. Functional finance meant using deficit spending to boost the economy or correct a market failure where necessary.

Lerner’s spirit lives on in a recent Levy Institute Public Policy Brief, “**Can Biden Build Back Better**.” Yeva Nersisyan of Franklin and Marshall College and L. Randall Wray of Bard College claim that the policy of “budget-neutral” spending—which requires that budget cuts “pay for” or offset new federal spending—could hobble the Biden administration’s effort to spend trillions on new asphalt and digital highways.

“The ‘pay-for’ approach limits our spending on progressive policy to what we can raise through taxes, and we will only tax the amount we need to spend,” Wray and Nersisyan write, noting that such a policy “undermine[s] the goals internal to both the public investment and tax components of the administration’s plans.”

Echoing Lerner, Nersisyan and Wray recommend that the importance of a public policy goal, rather than its cost, should guide spending and taxation decisions. “If the purpose of taxing corporations and wealthy individuals is to reduce inequality, then the tax changes should be formulated to accomplish that—not to ‘raise funds’ to finance proposed spending,” they write.

“And while it is possible that general tax hikes might be needed to prevent public investment programs from fueling inflation… the kinds of taxes proposed by the administration would do little to relieve inflationary pressures should they arise,” they write. “Under current economic circumstances, however, the president’s proposed infrastructure spending should not require budgetary offsets or other measures to control inflation.”

“How Much Does Social Security Offset the Motherhood Penalty?” Center for

Retirement Research at Boston College. *Issue in Brief*, July 2021, Number 21-11.

Social Security's rules both favor and punish spouses—primarily women—for the time they spend out of the workforce and at home raising children. This report from the Center for Retirement Research (CRR) at Boston College tries to net out the pros and cons of that policy.

In their **paper**, Matthew S. Rutledge, Alice Zulkarnain, and Sara Ellen King (current and former CRR researchers) found that, on average, mothers miss a lot of Social Security benefits by staying at home when they might have been at work, contributing to the program and earning credits.

But the program helps after they retire. "Social Security is able to offset a significant amount of the penalty by the time mothers reach retirement through two separate channels: the progressive design of worker benefits and the availability of spousal benefits," they write.

Non-working mothers tend to benefit from the tilt of Social Security benefits toward low-earners. They also benefit from the rule that provides them with at least half of their working spouses' monthly benefit in retirement. In addition, surviving widows and widowers—whether they worked for pay or not—can receive the higher of their late spouses' benefit or their own until they die.

The study finds that mothers earn, at the median, only 37% as much as childless women during their lifetimes. Median earnings for childless women are $3,850 per month, compared to $1,409 for women with children. But mothers receive, at the median, 60% as much in Social Security benefits as childless women.

The median Social Security benefit is $1,301 per month for childless women and $785 per month for mothers. Retired mothers with one child receive a median $974 per month from Social Security, while mothers with two children receive $847 per month.

Eighty years ago, at the birth of Social Security, men typically worked and women typically stayed home. But a lot has happened since then, like two waves of "feminism." "In recent generations, women's labor force participation and earnings have increased, so more women get Social Security benefits solely on their own earnings record," the researchers wrote. But "as marriage rates have decreased and divorce rates have increased, fewer women meet the 10-year marriage threshold. [So] the share of women receiving a spousal benefit has plummeted from 35% in 1960 to 18% in 2019."

"How Americans Respond to Idiosyncratic and Exogenous Changes in Household Wealth and Unearned Income" (NBER Working Paper No. 29000, July 2021)

If you won a Lotto jackpot or received some other financial windfall near your retirement age, would you work fewer hours? Would you retire? Would you move to a nicer house in a better neighborhood? Alternately, how would you respond to a hike in your marginal income tax rate?

Hoping to anticipate the domino effects of the introduction of a Universal Basic Income (UBI) in the US and a marginal tax hike on the wealthy to pay for it, four economists set out to learn if those policies would have the intended effect, or if they might backfire.

Combining "administrative data on US lottery winners with an event-study design that exploits variation in the timing of lottery wins," University of Chicago researchers Mikhail Golosov, Michael Graber, Magne Mogstad and David Novgorodsky found that wealthier and poorer people respond differently to windfalls.

On average, "For an extra $100 in wealth, [US] households reduce their annual earnings by approximately $2.30," the authors write. But averages hide the disparity between rich and poor. "Households in the bottom quartile of the pre-win income distribution reduce their annual household labor earnings by $1.30 per $100 dollars of additional wealth, whereas winners in the top quartile decrease their annual household labor earnings by $3.10 dollars per $100 of additional wealth," the paper said.

In other words, poorer people tend to keep their day jobs and buy more stuff when they hit the jackpot. Richer people, who presumably already own lots of stuff, tend to "prioritize reducing labor over increasing consumption."

The researchers also sought to learn if raising a poor family's disposable income with a UBI would inspire it to move to a better neighborhood where the housing stock, the schools, and the chances for upward social mobility might be greater.

Again, poor and wealthy families appeared to respond differently. Not surprisingly, "Lower-income households are much more likely to move: the increase in the probability of moving for winners in the lowest quartile is around five times as large as that of the winners in the highest quartile for an extra 100,000 dollars in wealth."

But the effect is diluted by other factors. "Pure unconditional cash transfers do not lead households to systematically move to locations of higher quality, consistent with the [welldocumented] importance of non-financial barriers to moving to better neighborhoods."