

## **How Should Fiscal and Monetary Policies Interact?**

- **Simple Answer – They Shouldn't**
- **Real Question -- Will They Have To Interact?**
- **Answer – Yes, If Fiscal Policy is Unsustainable**
- **The CBO's Deceit and the Morning After**
- **The Coming Generational Storm**
- **Generational Accounting**
- **Monetary Policy and Generational Accounting**
- **The Fed's Most Recent GA Findings**
- **Will the Economy Save Us?**
- **Is the U.S. Facing Hyperinflation?**

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# **The ABCs of Generational Accounting**

$$\mathbf{A + B = C + D}$$

**A -- PV Net Tax Burden on Future Generations**

**B – PV Net Tax Burden on Current Generations**

**C – PV of Discretionary Spending**

**D – Official Government Net Debt**

## Monetary Policy and Generational Accounting

$$A + B = C + D$$

If A is too big, use inflation to

- Lower D
- Raise B by increasing real seigniorage
- Raise B by raising taxes via bracket creep
- Raise B by cutting real transfer payments
- Lower C but cutting real spending

Time Honored Practice in Latin America, Russia, and Eastern Europe, but Tougher Sledding in the U.S. because

- D is in large part short term
- B is in large part inflation indexed
- Much of C is government salaries

## Alternative Policies to Achieve Generational Balance

<u>Policy</u>	<u>Current Policy Including 2001 Tax Cut</u>		<u>Current Policy Excluding 2001 Tax Cut</u>	
	<u>Immediate and Permanent Percentage Change in Policy Instrument</u>	<u>Equalized Lifetime Net Tax Rate</u>	<u>Immediate and Permanent Percentage Change in Policy Instrument</u>	<u>Equalized Lifetime Net Tax Rate</u>
Raise Fed. Inc. Taxes	68.2	26.1	56.1	26.1
Raise All Taxes	25.7	26.6	22.1	26.5
Cut All Transfers	43.5	25.0	38.5	25.2
Cut All Govt. Purchases	38.9	17.7	34.4	18.7
Cut Federal Purchases	116.9	17.7	103.5	18.7

Note: Generational imbalance is the percentage difference in lifetime net tax rates of newborns and future generations. Source: Calculations by Jagadeesh Gokhale of the Federal Reserve Bank of Cleveland and Laurence J. Kotlikoff of Boston University.

## Will the Economy Save Us? Simulating the Demographic Transition

Year	National Income	Capital Stock	Effective Labor Supply	National Saving Rate	Before-Tax Wage	Interest Rate	OASDHI Cost Rates	
							Model	SSA
2000	1.000	1.000	1.000	.046	1.000	.075	.137	.131
2005	1.091	1.064	1.101	.044	.992	.077	.145	.136
2010	1.191	1.137	1.209	.047	.985	.079	.158	.147
2020	1.361	1.271	1.393	.030	.977	.081	.197	.183
2030	1.529	1.366	1.587	.011	.963	.084	.243	.220
2050	1.889	1.500	2.039	.015	.926	.095	.257	.237
2075	2.479	1.845	2.736	.023	.906	.101	.264	.262
2100	3.303	2.421	3.663	.027	.902	.103	.265	na

Source: Kotlikoff, Smetters, and Walliser (2001)