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GENERATIONAL THEFT, THRIFT, OR INVESTMENT

What the National Debt, Medicare, and Social Security Mean for Future Generations

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Debt is a concept we can all relate to. At some point during our lives, nearly all of us must borrow money to finance activities like buying a car, paying for a college education, or bridging a period of unemployment. In itself, debt is neither inherently good nor bad; rather it is merely a tool. Its value is entirely contingent on its purpose. Taking out a loan to finance a college education—an investment with clear future returns—is categorically different than borrowing to finance unnecessary lavish purchases. We can think about government debt in a similar fashion; what led to the federal government's debt is just as important as the total dollar value of debt incurred.

But the analogy between household and government debt falls short, however, with long-term and very large investments. Unlike individual households, it is reasonable to assume that governments (at least those in developed economies) will not go bankrupt and can operate with the assumption of very long-time horizons. Governments can thus spread both spending and revenue collection across many years into the future, and even across different generations. It is this ability that has historically drawn vocal criticism, most recently in debates over the economic stimulus and health care reform.

Politicians and pundits such as House Minority Leader John Boehner, Senator John McCain, as well as former U.S. Comptroller General David Walker have invoked the concept of "generational theft" to describe recent increases in spending and deficit levels.[1] This perspective of preceding generations robbing the next is not new, and has been used since the New Deal to criticize future government obligations, particularly (but not exclusively) major social insurance programs for the elderly like Social Security and Medicare (Williamson and Watts-Roy 1999). So what do deficits, debt, and fiscal policy mean for future generations? Are we really, in the words of David Walker, "mortgaging our grandchildren's future" through deficit-financed public investment? How do we ensure that all generations are treated fairly? This paper examines these questions by evaluating generational arguments against government spending in the form of deficit-financed public investment and social insurance benefits and puts forth an alternate perspective for assessing how public policy affects different generations.

Deficit-financed public investment spending: generational theft?

Martin Feldstein, the chairman of President Reagan's Council of Economic Advisers, summarizes the opposition to deficit-financed public investments well, asserting that "[f]iscal deficits impose a burden on future generations; borrowing only postpones the time when taxes will have to be paid" (Feldstein February 12th, 2004). While it is true that future generations will inherit the obligation of repaying past debts, they will also inherit the *benefits* of deficit-financed public investment spending (the generational burden argument is irrelevant if new spending is completely accounted for by new revenue). Government spending, when deployed effectively, can result in investments with important returns for years to come. Public spending on infrastructure—highways, airports, and rail lines—and human capital—high-quality education and healthy populations—are critical for a well-functioning economy and competitive workforce.

Spending on early childhood development and education is perhaps one of the best examples of positive public investment. Extensive economic and cognitive research has demonstrated that investments in early childhood development (particularly before the age of five) prove to have very high (and long-lived) returns at very low levels of risk (see for example, Isaacs 2008). An individual's success in the labor market and quality of life is strongly influenced by their first years in childhood. The long-term benefits of early investment in child development, particularly in disadvantaged youth, include lower spending on remedial and special education, lower spending on health interventions, increased school completion and higher academic achievement, higher incomes (and therefore tax payments), lower spending on means-tested income assistance, and lower criminal justice costs (see for example, Heckman and Masterov 2007). The returns are estimated to be between $13 and $17 per dollar spent on early education (Calman and Tarr-Whelan 2005). Ultimately this sort of public investment—whether in education or physical infrastructure—lays the foundation for future growth, increasing the size of our total national economy and thus reducing debt as a share of our gross domestic product.

Large-scale public investment (and deficit-financed public investment) is not a phenomenon isolated to the mid- to late-20th century. Government investments in infrastructure (particularly rail lines and sewage systems) facilitated the rapid urbanization and industrial development of the Industrial Revolution. The Louisiana Purchase (1803), the Homestead Act (1862), and the Land-Grant College Act (1890) that founded the public state university system are also all examples of expensive—yet crucial—investments by the U.S. government in the well-being of future generations. Their gains are still being realized today.

A final argument for using deficits to finance public investments is that future generations will likely be wealthier and in a better position to pay off our debt obligations. Today's elderly have lived through extraordinary advances in technology that have raised living standards for all and generated considerable economic growth. To be sure, these gains have not been shared equally, but collectively they have meant that current generations are substantially better off than past generations. We can ensure that this trend will continue by making the same sort of productive investments—in human capital, technology, and infrastructure—discussed above. U.S. debt also provides an important asset for current and future generations' wealth. Treasury bonds, especially with the creation of inflation-provided securities, provide a safe and important vehicle for diversified investment that benefits savers.

Public investment spending in recessions

Public investment is even more essential throughout periods of economic contraction. During the Great Depression, large and sustained public investment was crucial to generating demand that, coupled with the Second World War, pushed the economy toward recovery and expansion. Similarly, public investment has been essential during the current economic downturn. This is because the government's traditional policy lever for stimulating investment—lowered interest rates—has currently reached its limit. Interest rates are essentially at zero and cannot be lowered further. The

only tool left for the government is to generate demand through fiscal stimulus spending. Given the magnitude of the necessary spending, some are concerned about the debt that will be generated for future generations. This is a misplaced fear. The far more important concern is the effect that an economic recession will have on future generations, such as threatening educational achievement, economic mobility, and entrepreneurial activity (Irons 2009).

Without concerted government intervention, a recession will be devastating for children, both immediately and in the future. A broad body of research has linked childhood poverty to numerous negative effects, including reduced health and academic achievement. The United States already has one of the highest child poverty rates for an industrialized economy, second only to Mexico (UNICEF 2008), and this rate will only increase with a worsening labor market. Even with the stimulus package passed by Congress, economists have predicted that the current recession will raise the child poverty rate to 27% by 2010, and will be even worse for minorities, reaching 50% for black children (Mishel 2009). Others have forecasted that all progress made in family and child well-being (as measured by improvements in health, safety, education, and social and emotional well-being) since the 1975 will be wiped out (Land 2009). Based on data from previous recessions, it is also clear that even children who are briefly exposed to poverty, or levels close to the poverty line, will feel the effects well into adulthood through poorer health and lower socioeconomic status (FirstFocus 2009). Given the harmful effects of a recession on future population well-being, there is a strong *generational* argument *for* aggressive fiscal stimulus.

Social insurance programs: greedy geezers?

The key to understanding the effects of government spending on future generations is to consider generations not just as groups at a static point in time, but over an entire lifetime. Such a perspective captures not only the liabilities created by future taxes, but also the benefits produced by effective public spending. This is one of the principal failings of analyses that focus solely on the net tax burden for specific generations, such as the method of "generational accounting" (Auerbach et al. 1999; Gokhale and Smetters 2006). Generational accounting has fueled concerns that the net tax liability for future generations is rising, given increased public spending, particularly on our social insurance programs. This in turn has supported the perspective that spending on the elderly—largely through Social Security and Medicare—crowds out spending on the young (see, for example, Kotlikoff and Burns 2004 and Sawhill and Monea 2008). This is the second generationally grounded argument against government spending this report evaluates.

Proponents of this perspective cite that the share of children's spending in the federal budget is just 2.6% of GDP, compared to 7% for the elderly (Carasso et al. 2008) (although it should be noted that this vastly understates spending on children, as the majority of public expenditures for Medicaid and primary schools occurs at the state level). This situation, they contend, is considerably worsened by our nation's aging population—starting with the Baby Boomers—and will only exacerbate the generational inequities we currently face. These arguments also note that the material and health outcomes of the elderly have dramatically improved, while those of children have stagnated or worsened. For example, the median income of those 65 and over has increased 79% since 1979, and their poverty rate has fallen by one-third to 9% over the same period (Sawhill and Monea 2008). In contrast, the number of children under 18 living in poverty has held relatively constant at 17% (Census 2008).

This view is flawed on two levels. Fundamentally, it ignores the possibility that different generations can contribute to one another, and in turn, that government policies can have additional effects beyond cash transfers. Social policies have many positive externalities, both for the direct recipients, their families, and the broader economy. For instance, social policies that pool and diffuse uncertainty and risk encourage workers to undertake long-term investments, such as training and education, or pursuing new employment that better matches their skills. These are activities that will ultimately benefit both the worker and the economy, but are less likely to be undertaken if individuals do not have a safety net should they fail (Sinn 1995). The government can also ensure against risks that private markets cannot by constructing large risk pools, preventing adverse selection by mandating enrollment, and operating with a uniquely long time horizon (Moss 2002).

Public policy can also have positive spillover effects to families, encouraging non-monetary transfers between generations of time and care. Nearly 4 million children are being raised by their grandparents and a third of older Americans report providing some child care for their immediate family members (Hayslip and Kaminski 2005). In addition to directly contributing to children's welfare, child care offered by the elderly is often what allows young parents to participate in the labor force, especially in the case of low-income mothers (Fuller-Thomson and Minkler 2001; Hayslip and Kaminski 2005). Conversely, the economic independence generated for the elderly by social insurance programs such as Social Security and Medicare relieves families of much of the economic cost of supporting their elderly relatives, permitting parents and guardians to invest resources in their children. Old age pensions have thus provided security against the risk of financial strain for both the elderly and the young throughout history (Haber and Gratton 1994).

The "zero-sum" perspective of government spending is also refuted by empirical analysis. Extensive cross-national studies have shown that there is no trade-off between spending on children and spending on adults. Rather, the opposite is true: countries that spend relatively more on one group also spend relatively more on the other (Brady 2004; Pampel 1994; Quadagno 1989). On the other hand, arguments regarding generational inequity and conflict are generally strategies to initiate *retrenchment* of social programs in the United States and other post-industrial economies (Marmor et al. 1994; Pampel 1994).

Compared to other developed (and even some developing) nations, the well-being of American children clearly lags. But cutting spending directed toward the elderly will not automatically improve living standards for children; in fact it may *lower* them. Furthermore, there are still large disparities in socioeconomic status for the elderly, such that cutting benefits any further could be highly detrimental. While the elderly and retired have indeed enjoyed significant material and health gains— largely due to the success of Social Security and Medicare—a significant portion still remain below 200% of the poverty line—over 13 million in 2007, with minorities and women starkly overrepresented (Census 2008). Thus, while the reduction in the average elder poverty rate over the past century is certainly cause for celebration of effective government action, much work still remains to be done for both the young and the old alike.

How to think about generational fairness: risk and risk sharing

In light of the flaws of generational accounting and the broader "generational inequity" framework, how should we think about the effect of government policy on different generations? A risk-sharing perspective is far more effective to capture the actual experiences of individuals and generations. Under an intergenerational risk-sharing perspective, a country's generational contract would be judged by how well risk is pooled and shared across and between different age cohorts. Generational fairness would be achieved when major risks were shared equally across different generations. In the United States, this perspective finds that the principal avenues for risk sharing between generations for health and retirement security (namely defined-benefit pensions and broad-based community-rated health insurance) have diminished, while risks have remained constant, and in the case of health care, have increased due to skyrocketing health care costs (Hertel-Fernandez 2009). That both the young *and* the old are exposed to increasing risk with fewer mechanisms for insuring against those risks belies accounts of an American welfare state that is overly generous for the elderly and shows the need to shore up protections for all age groups. Further pooling of risk—either for income loss or for medical expenditures—could be a key mechanism for improving protection and overall generational equity.

Conclusion

There is serious reason to be concerned about the sustainability of American fiscal policy. High continuous deficits during periods of full employment have the potential to crowd-out private investment, particularly if the government is providing services and goods that would have been otherwise generated by the private sector. If debt service payments grow too large, they will limit other federal spending. More importantly, large deficits hinder the government's ability to engage in

fiscal stimulus during future economic downturns. However, fiscal policy is ultimately a tool. Public spending, deficits, and balanced budgets are means to achieve our broader values and goals, such as shared opportunity and prosperity.

Generational fairness is another important goal for any society. Unfortunately, its application has become distorted in the discussion of American fiscal and social policy. Deficit spending, when directed toward positive investments, can generate important returns for future generations. This is particularly true for fiscal stimulus during a recession, which is vital to ensure the well-being of children. Furthermore, perspectives of generational fairness that pit the young and the elderly against one another when considering social insurance programs such as Medicare and Social policy are fruitless and lack empirical grounding. Truly equitable generational policy ought to share risks broadly across all generations.

Endnotes

1. See, for example, "Generational Theft?" by Marc Ambinder: http://politics.theatlantic.com/2009/02/generational_theft.php; "Stimulus Bill is Generational Theft: McCain" in *CBS News Political Hotsheet*: http://www.cbsnews.com/blogs/2009/02/08/politics/politicalhotsheet/entry4783514.shtml; and "Ten Trillion and Counting" PBS *Frontline Special*: http://www.pbs.org/wgbh/pages/frontline/tentrillion/interviews/walker.html.

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