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EXPERTS IN GLOBAL INVESTING

A coming political fight due to the pandemic? Intergenerational equity

The young will want to be compensated for protecting the elderly from covid-19. But their quest will come with risks.

Tom Moore of Bedfordshire sought to raise 1,000 pounds to help the UK's National Health Service cope during the coronavirus pandemic. He decided to walk 100 times back and forth across his backyard of 25-metres length by his birthday on April 30. How hard is that? If you are a 99-year-old holding the rank of captain from the Burma and India campaigns of World War II and need to use a walker with wheels after breaking your hip a year earlier, it's an effort.

The UK public treasured the feat and Moore, who achieved his goal two weeks ahead of schedule in front of an army guard of honour, became a household name after his family promoted his efforts on social media. Just before his 100th birthday, Moore's recording of the Gerry and the Pacemakers song You'll Never Walk Alone made him the oldest person to top the UK music charts and boosted the amount raised for the health system to 55 million pounds.[1]

Bravo to Sir Tom – for he was knighted by Queen Elizabeth II after 500,000 people signed a petition. But younger generations might think that their older peers will need to do much more to compensate them for the way society has been economically ravaged to protect the elderly from the SARS-CoV-2 virus. Policymakers were aware when they froze everyday life, interrupted schooling and crushed their economies that the covid-19 illness mostly kills those over 70 years of age, while largely sparing the young.[2] While governments handed out mammoth financial support to workers of all ages as they flattened their economies, an idea is taking hold among the young, even those still at school, that they are long-term losers financially. They see that they, and possibly unborn generations, will need to repay this largesse that the IMF forecasts will propel public debt beyond post-World War II highs.[3]

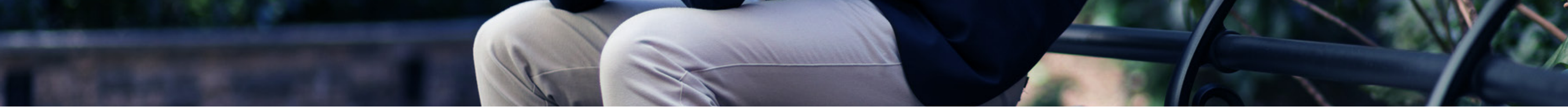
The financial blow to younger generations extends to the employment market ruined by covid-19. Younger workers have been hit relatively harder than older ones in three ways. The first is that people who graduate during recessions are usually handicapped for years as they struggle to find appropriate work. A UK study from 2017 found that finishing education over the past three UK recessions (when the jobless rate rose on average four percentage points) had such "scarring effects" on employment prospects and pay for at least five years.[4] A US study from 2012 found the financial blow for university graduates can last a decade if their job search starts during a downturn.[5] That means many Millennials (born 1981 to 1996) were still to recover from the global financial crisis when the coronavirus struck.

Another setback was the young were overrepresented in the industries such as tourism, hospitality and leisure that were the hardest hit by restrictions to slow infection rates. A UK review in April found "workers under the age of 25 are two and half times as likely as those over age 25 to work in sectors that have been closed down".[6] Unemployment is likely to stay elevated for years and many of the jobs lost won't reappear. A US study from May forecasts that 42% of recent US layoffs will result in "permanent job loss".[7]

Another knock for the young was that companies tended to retrench them because they are generally the cheapest to let go, possess less corporate memory and are the least skilled. A US survey found that by mid-April 52% of people under the age of 45 had lost jobs, been put on leave, or had hours reduced due to the pandemic compared with 26% of people aged over 45.[8]

The employment blows for the young and the debt burden they face are stirring a political fight over intergenerational equity, a concept that says each generation should be fair to future generations. In financial terms, that means each generation should leave a functioning economy and no unreasonable debt burden for descendants.[9]

Any intergenerational fight triggered by the coronavirus will be fought in four areas. The pivotal showdown will be over how to reduce government debt. The young will push policymakers to prioritise growth and let inflation erode the real value of debt because inflation favours borrowers (the young with personal debts) over lenders (the elderly with savings), even if this option risks higher interest rates that boost repayments.



The second clash will centre on fiscal stimulus as the young demand a return to the pre-covid-19 jobs markets. The job-creating fiscal solutions the young are likely to advocate will risk inflation. Some proposals might even risk a crisis over public finances because they include radical 'magic money' ideas that governments can run endless deficits until full employment is reached. But such remedies would likely mean higher interest rates for a world shaped only for low rates.

The third fight will be over the composition of fiscal policy. On the revenue side, the young fight against higher income and inheritance taxes while sanctioning wealth (property) and capital-gains taxes that more target the elderly. The spending side will feature a battle over education, job creation, aged care and healthcare to name four flashpoints, where the young will fight for spending on skills and jobs. The risk here is that politics will drive changes that impede economies.

The fourth clash will be over the priority given to combating climate change. While older generations won't necessarily oppose demands of the young to phase out fossil fuels, such steps are fraught politically and could provide cover for over-aggressive 'New Green Deal' fiscal stimulus. How these four fights are resolved could well influence the course of economies in coming decades. The danger is they could usher in policies that derail economies.

The biggest question in any fight over intergenerational equity is assessing whether or not the young have been excessively burdened to protect the old. Authorities acted to safeguard all of society from a virus that could well mutate in a way that threatens younger generations. Much of the economic damage was due to the way people, including younger ones, 'self isolated' to protect themselves. Men are dying at greater rates than women though female workers are overrepresented in shut-down industries. Minorities in the US are being struck harder than whites. The wealthy are better protected than the poor. And so on. But in broad terms – and certainly in the political optics so far – it's true enough that financially the young are being burdened to protect the old, even if many elderly are suffering moneywise too. The interruption to education in at least 107 countries could perhaps be added to the young's financial costs though the stoppage might need to last longer to do so.[10] Perhaps we shouldn't feel too sorry for the young. Innovation and productivity gains will most likely ensure over their lives they enjoy a higher standard of living than today's elderly, even if government finances and the employment market are a mess for a while. An intergenerational fight was coming anyway because the Baby Boomers (born 1946 to 1964) were already leaving behind large public debts.[11] The virus has just intensified the intergenerational tussle.

If working-age generations seek to lighten their financial burden and that of later generations, the battle might comprise so many skirmishes it could be hard to judge which generation is winning. As inflation cuts across many areas of contention, perhaps it will be the best guide to the victor. But the winner might only be ahead in a relative sense.

TACKLING DEBT

Peter Costello on becoming Australian treasurer in 1996 was told the outgoing Australian Labor Party government had left an underlying budget deficit of A$7.6 billion rather than an assumed shortfall of only A$0.6 billion.[12] Costello used the budget 'black hole' to pass the Charter of Budget Honesty Act 1998.[13] This law is best known for updating the state of Canberra's finances at the start of election campaigns. Another innovation was intergenerational reports.

These documents to be produced every five years after the first one in 2002 (and so far in 2007, 2010 and 2015)[14] evaluate whether Canberra's finances over the next 40 years will ensure intergenerational 'equity' and 'sustainability'. A government-sponsored paper of 2003 attempted to define these contested concepts.[15] It concluded "the two rationales are based on the goal of the sustained quality of life and a 'benefiter-pays' principle of fairness". The coronavirus leaves enough debt to threaten the first and poses a quandary as to how to achieve the second.

Economists might suggest the best way to lower public debt burdens is to ensure that economies grow briskly; more specifically, that nominal output (GDP plus inflation) grows at a higher rate than the average interest rate on public debt.[16] This was largely how advanced countries eroded the debt amassed to fight World War II. US federal debt, for instance, fell from 119% of GDP in 1946 to under 35% of output by 1970[17] even though the dollar amount jumped 46% to US$381 billion over the 25 years – the US economy had simply hummed; it expanded an average annual rate of 4% over the 1950s and 1960s.[18]

But hidden within these statistics were two conditions that favoured the young over the elderly. The first was that inflation was tolerated. In the US, annual inflation averaged nearly 3.5% over those 25 years. In Australia, annual inflation averaged 4.2% over the 1950s and 1960s (when annual growth averaged 4.7%).[19] The other condition was that policymakers used the law to suppress interest rates – a practice known as 'financial repression' and one that disadvantages elderly savers.[20]

Even if today's young fought to reinstall those two conditions they would still need the economy to thrive and that will depend on future policies and innovation driving productivity gains. The longer the outlook that people take, the more technological-driven productivity advances might alleviate government debt burdens. But if those of working age are impatient they are more likely to favour policies that allow inflation to erode public debt, even if that option comes with other costs.

SORTING OUT STIMULUS

One Sunday evening in August 1971, US President Richard Nixon commandeered prime-time TV to announce three fixes for a US economy damaged by overspending on the Vietnam War. His remedies were controls on wages and prices, an import tax and the suspension of the Bretton Woods Agreement that, via the gold-backed US dollar, had governed world trade since World War II. And by adjourning the convertibility of the US dollar into gold, Nixon ushered in the modern era of 'fiat' money – when money is of no intrinsic value. In reaction, Federal Reserve chairman John Burns confided in his diary: "Are we going to build a new world in sheer bluff and bombast?"[21]

"Yes" would be the answer when assessing magic-money solutions such as Modern Monetary Theory that is pushed by many (on the left[22]) who say that because governments can't default in their currency they can perpetually create fiat money to ensure full employment.[23]

The problem with theories that essentially say government deficits and debt don't matter is they are refashioned money printing – when governments hand money to the public without borrowing it first. Money printing is generally inflationary – even hyper-inflationary – because more money is chasing the same amount of goods and services. Expect rising support for such theories because, as studies show, the young will realise that inflation works in their favour.[24] Expect much resistance, however, to a concept that Fed Chair Jerome Powell labels "just wrong".[25]

More sober pro-inflation solutions would be for central banks to target nominal GDP rather than just inflation because the twin goals of tame inflation and full employment are usually mutually exclusive. The centrist young are likely to back long-standing calls for central banks to target between 4% and 5% a year for nominal GDP, which could mean inflation of up to 5% during recessions. Authorities might still baulk at a change that might mean higher interest rates among other outcomes.

And then there is the fight within fiscal policy that could alter incentives across the economy. In Australia, the tax and benefits and retirement systems give the elderly several advantages over younger people that could come under scrutiny. The seniors and pensioners tax offset, for instance, can mean that many retirees pay less tax than younger people with the same income.[26] In the US, the intergenerational fight could focus on extending free medical care to all rather than just for those aged 65 years and older. The stoush could look at tax deductions for mortgage payments, a policy that favours the elderly who own their homes. Expect to hear more calls to forgive student debt and give everyone a 'basic income', steps that favour the young but come with disadvantages. Maybe all ages will want to increase corporate tax rates.

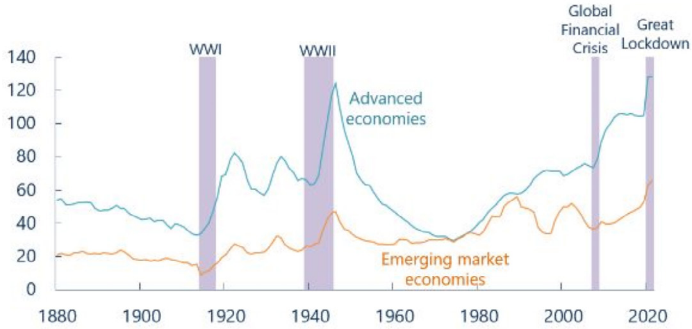
As support among the young for Green New Deals shows, climate change will remain a political focus. The young will justify spending to combat global warming because in intergenerational terms it protects the young and the unborn and it doubles as fiscal stimulus.[27]

While the policy divides over the fight about intergenerational equity are clear, the outcomes will depend on how much fight the young have in them. Can they match the resolve of Sir Tom?

By Michael Collins, Investment Specialist

Global public debt is expected to exceed the post-World War II peak

(Gross public debt, percent of GDP)



Sources: Historical public debt database; IMF World Economic Outlook, Maddison Database Project and IMF staff calculations. Found at blogs.imf.org/2020/06/24/reopening-from-the-great-lockdown-uneven-and-uncertain-recovery/

[1] See BBC. ‘Captain Moore tops the charts at the age of 99.’ 24 April 2020. bbc.com/news/entertainment-arts-52415966. See the performance on YouTube. ‘You’ll Never Walk Alone – Captain Tom Moore, Michael Ball & The NHS Voices of Care Choir’. 17 April 2020. youtube.com/watch?v=wUP-ty-Tj5E. As a sign of Moore’s popularity, the Royal Air Force conducted a flypast over his locked-down home town on his birthday. A closed local school was needed to display the 150,000 birthday cards he received.

[2] The latest research shows UK school children have more chance of dying from lightning. See The Telegraph. ‘School age children are more likely to be hit by lightning than die of coronavirus.‘ 11 June 2020. telegraph.co.uk/politics/2020/06/09/school-age-children-likely-hit-lightning-die-coronavirus-oxbridge/

[3] IMFBlog. Gita Gopinath. ‘Reopening from the Great Lockdown. Uneven and Uncertain Recovery.’ 24 June 2020. blogs.imf.org/2020/06/24/reopening-from-the-great-lockdown-uneven-and-uncertain-recovery/

[4] Institute for Fiscal Studies. ‘Entering the labour market in a weak economy: scarring and insurance.’ IFS Working Paper W17/27. 30 November 2017. ifs.org.uk/publications/10180

[5] American Economic Association. ‘The short- and long-term career effects of graduating during a recession.’ American Economic Journal: Applied Economics. Vol 4, No 1, January 2012. Pages 1 to 29. aeaweb.org/articles?id=10.1257/app.4.1.1. To go straight to the paper: pubs.aeaweb.org/doi/pdfplus/10.1257/app.4.1.1

[6] Institute for Fiscal Studies. ‘A bad time to graduate.’ 17 April 2020. ifs.org.uk/publications/14816.

[7] National Bureau of Economic Research working paper No. 27137. ‘Covid-19 is also a reallocation shock.’ May 2020. nber.org/papers/w27137?utm_source=newsletter&utm_medium=email&utm_campaign=newsletter_axiosmarkets&stream=business

[8] Data For Progress. ‘The staggering economic impact of the coronavirus pandemic.’ 9 April 2020. filesforprogress.org/memos/the-staggering-economic-impact-coronavirus.pdf. Evidence of the damage is that US youth unemployment (16 to 19 years old) surged from 12.2% in January to 29.9% in May. US Bureau of Labor Statistics. ‘Table A-1. Employment status of the civilian population by sex and age.’ May 2020. The overall jobless rate rose from 3.6% to 13.3% over the four months. bls.gov/news.release/empsit.t01.htm

[9] Pew Research Centre. ‘Positive economic views plummet: support for government aid crosses party lines.’ 21 April 2020. The poll found that 69% of those aged 65 and older think the economy will be better in a year. By contrast, only 42% of those aged 18 to 29 think things will be better, while 34% expect conditions to be worse in a year. people-press.org/2020/04/21/positive-economic-views-plummet-support-for-government-aid-crosses-party-lines/

[10] See The Lancet. ‘School closures and management practices during coronavirus outbreaks including covid-19: a rapid systemic review.’ 6 April 2020. thelancet.com/journals/lanchi/article/PIIS2352-4642(20)30095-X/fulltext

[11] For a view on how poorly Millennials were placed anyway, see Joel Kotkin. ‘The coronavirus means Millennials are more screwed than ever.’ Daily Beast. 16 May 2020. thedailybeast.com/the-coronavirus-means-millennials-are-more-screwed-than-ever. (Subscription required. Much of the article can be found here: newgeography.com/content/006649-the-coronavirus-means-millennials-are-more-screwed-than-ever)

[12] See The Australian. ‘Cabinet papers 1996-1997: Beazley’s “black hole” greeted new treasurer Peter Costello.’ 31 December 2018. theaustralian.com.au/national-affairs/beazleys-black-hole-greeted-new-treasurer-peter-costello/news-story/1769924088bce3371a487122fdd096d6

[13] To view Australia’s Charter of Budget Honesty Act 1998, go to: legislation.gov.au/Details/C2020C00126. Politically, Costello used the Labor Party’s budget “black hole” to smear the concept of budget deficits (and the ALP’s record of fiscal management) that still resonates through politics.

[14] To view the Australian Government’s 2015 Intergenerational Report, go to: treasury.gov.au/publication/2015-igr

[15] Department of Parliament Library. Information and Research Services. Research Paper No. 7 2002-03. ‘Intergenerational equity: Issues of principle in the allocation of social resources between this generation and the next.’ Assoc. professor Janna Thompson. Consultant. Social Policy Group. 13 May 2003. aph.gov.au/binaries/library/pubs/rp/2002-03/03rp07.pdf

[16] See Olivier Blanchard. ‘Public debt and low interest rates.’ Working paper 19-4. February 2019. piie.com/publications/working-papers/public-debt-and-low-interest-rates. He responds to criticism of the paper here: ‘Why critics of a more relaxed attitude on public debt are wrong.’ 15 July 2019. piie.com/blogs/realtime-economic-issues-watch/why-critics-more-relaxed-attitude-public-debt-are-wrong

[17] Federal Reserve Bank of St Louis. ‘Gross federal debt as a percentage of gross domestic product.’ To view in chart form, go to: fred.stlouisfed.org/graph/?id=GFDGDPA188S. US growth rate from tradingeconomics.com. tradingeconomics.com/united-states/gdp-growth-annual

[18] Federal Reserve Bank of St Louis. ‘Gross federal debt’. To view in chart form, go to: fred.stlouisfed.org/graph/?id=FYGFD,

[19] Department of the Treasury. ‘Australia’s century since federation at a glance.’ Inflation averaged 6% in the 1950s (after peaking at 24% in 1951) and 2.5% in the 1960s. Economic growth averaged 4.2% in the 1950s and 5.3% in the 1960s. treasury.gov.au/sites/default/files/2019-03/round3.pdf. See also Australian Bureau of Statistics. ’70 years of inflation in Australia.’ abs.gov.au/websitedbs/D3310114.nsf/home/ABS+Chief+Economist+-+70+Years+of+Inflation+in+Australia

[20] This is when banks, insurance companies, super funds and other owners of long-term debt are forced by capital controls, interest-rate ceilings and even legal requirements to invest in government bonds, usually at negative real rates.

[21] John Farrell. ‘Richard Nixon. The life.’ Scribe Publications 2017. Paperback edition 2018. Pages 444 to 448.

[22] It was the de facto policy in the UK’s Labour Party under Jeremy Corbin. It underpins the Australian Greens’ ‘Next Gen Guarantee’ that promises any Australian under 30 years of age free education, a liveable income or a decent job. See Australian Greens. ‘Invest to recover. A cleaner, fairer Australia. Beyond covid-19 towards a Green New Deal.’ greens.org.au/recovery

[23] See Stephanie Kelton, author of ‘The Deficit Myth’. ‘Why I’m not worried about America’s trillion-dollar deficits.’ The New York Times. 9 June 2020. nytimes.com/2020/06/09/opinion/us-deficit-coronavirus.html?campaign_id=39&emc=edit_ty_20200609&instance_id=19205&nl=opinion-today&regi_id=79468630&segment_id=30428&te=1&user_id=2e26c7c537c578b82df307b10345bfa2

[24] For one study that found inflation favours the young over the old, see Matthias Doepke and Martin Schneider. ‘Real effects of inflation through the redistribution of nominal wealth.’ CEPR discussion paper No. 5167. 18 August 2005. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=785927

[25] Bloomberg News. ‘Jerome Powell says the concept of MMT is “just wrong”’ 27 February 2019. bloomberg.com/news/articles/2019-02-26/jay-powell-is-no-fan-of-mmt-says-the-concept-is-just-wrong?sref=ORbm2mFs

[26] For some proposals, see ‘Forget GST tinkering and bring in real tax reform.’ Adam Creighton. The Australian. 3 July 2020. theaustralian.com.au/inquirer/forget-gst-tinkering-and-bring-in-real-tax-reform/news-story/24445ad7146baface9646a81dfdee55b

[27] Presumptive Democratic Party nominee Joe Biden says he will spend US$2 trillion on clean-energy infrastructure and other climate solutions if he becomes US president.

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