

Running Fiscal Policy With Blinders –

S. Korea Needs to Do
Fiscal Gap and Generational Accounting

Laurence Kotlikoff

Professor of Economics, Boston University
President, Economic Security Planning, Inc.

This Conference Concerns S. Korea's Fiscal Sustainability

The First Question:

How Should We Measure Fiscal Sustainability?

Neither S. Korea's Nor Any Country's Fiscal Sustainability ...

Can Be Measured Via the Conventional Measure, Namely Debt to GDP

None of the Following Fiscal Variables Is Economically/Mathematically Well Defined

Government Debt, Deficits, Taxes, Transfer Payments, Private Wealth, Government Wealth,
Disposable Income, Personal Income, Private Saving, and Personal Saving

Physics Also Has Measures Without Meaning –
Concepts that Aren't Mathematically Well Defined

Time and Distance Depend on One's Frame of Reference/Language.

Your Frame of Reference is Your Speed and Direction Through Space

Illustrating the General Relativity of Fiscal Language

- A Simple Example with a 10 percent Interest Rate
- The Government Receives \$1,000 from You Today and Gives You \$1,100 Next Year. Did It:
 - A) Tax You \$1,000 Today and Transfer You \$1,100 Next Year?
 - B) Borrow \$1,000 from You Today and Repay You Principal Plus Interest of \$1,100 Next Year?
- Or Did It ...

More Examples of the General Relativity of Fiscal Language

C) Borrow \$1,000,000 From You Today, Transfer \$999,000 To You Today, Repay You \$1,100,000 Next Year, and Tax You \$1,098,900 Next Year.

D) Tax You \$500,000 Today, Lend You \$499,000 Today, Receive \$548,900 in Principal Plus Interest From You Next Year, and Transfer \$550,000 to You Next Year?

Compared to Case A, Uncle Sam Reports a \$1,000 Larger Deficit in Case B, a \$1 Mil Larger Deficit in Case C, and a \$499K Larger Surplus in Case D

Measurement Without Meaning

- The Government Can Use Words to Report Whatever Time Paths of Debt and Other Fiscal Variables It Wants
- The Government Doesn't Have a Monopoly on Language. Each Of Us Can Choose Our Own Labelling Convention
- Hence, There is No Single, Correct Measure of Government Debt, Past, Present, or Future
- Nor Is There Any Single, Correct Measure of Any Other Conventional Fiscal Variable

Measurement Without Meaning

There is an Infinite Number of Measures of Government Debt

This Statement Holds for All Economic Models with Rational Agents

– Agents that Are Not Fooled by Language

See Green and Kotlikoff (2008), “On the General Relativity of Fiscal Language “ (See Kotlikoff.net/articles)

Message for S. Korea, the US, the UK, ..., the IMF, World Bank, and ...

Government Debt Reflects the Choice of Language

It's Not a Measure of Fiscal Sustainability

The S. Korean Government Must Use Language-Free/Label-Free

Fiscal Measures to Assess Its Fiscal Sustainability

My Message to All Governments and International Agencies

Your Ability to Put Obligations On and Off the Books

Via Choice of Words Renders Your Books (Official Debt) Meaningless

This Proposition Is Not New. I've Been Writing and Co-Writing About This for Almost Four Decades

- 1986 in [The Public Interest](#)
- 1987 in [Dynamic Fiscal Policy](#)
- 1988 in [Science](#)
- 1992 in [Tax Policy and the Economy](#)
- 1992 in [Generational Accounting](#)
- 2003 in [Generational Policy](#)
- 2005 in [The Coming Generational Storm](#),
- 2008 in [On the General Relativity of Fiscal Language](#)
- 2012 in [The Clash of Generations](#)
- And In a Plethora of Other Academic and Public Media Outlets since 2012.

Yet, Every Day, Top Economists Are Making Economic Arguments Based on Meaningless Numbers

Recent Examples

Ken Rogoff on [US Fiscal Policy](#)

Paul Krugman on [deficit spending](#)

Olivier Blanchard on [debt and low interest rates](#)

Greg Mankiw on the [deficit gamble](#)

Tyler Cowen on [monetizing the deficit](#)

Joseph Stiglitz on [deficit policy](#)

Lawrence Summers on [deficit 'doom loop'](#)

We Need Language-Free Measures of Fiscal Sustainability

The Fiscal Gap and Generational Accounting Are Language Free

So Is the Permanent Tax Hike or Spending Cut Needed to Eliminate the Fiscal Gap

These Measures Are Invariant to How One Labels/Describes Government Receipts and Outlays

The Fiscal Gap

Equals The Present Value of Projected Outlays Less the Present Value of Projected Receipts

Note, Annual Outlays and Receipts in Cases A, B, C, and D Are Identical.

Generational Accounting

Measures How Much More Young and Unborn Children Will Need to Pay,
Adjusted for Growth, If Current Adults Don't Help Close the Fiscal Gap

If Fiscal Burden Facing Today's and Tomorrow's Children Is Exorbitant, Policy Is Unsustainable

Fiscal Gap Accounting in Practice

The EU Has Been Doing Official Fiscal Gap Accounting Every Three Years Since 2006

This is the S2 Indicator in the EU's Tri-Annual Fiscal Sustainability Reports.

The US Government Does Neither Fiscal Gap Nor Generational Accounting

The Same is True for the Governments of the UK, China, Japan, ..., and S. Korea

Closing the U.S. and UK Fiscal Gaps

Requires Raising Taxes by Roughly 8 Percent of GDP in Each Country,

Immediately and Permanently

Note: Calculations Based on Congressional Budget Office and the Office of Budget Responsibility Projections

Closing the French, German, Italian, and Spanish Fiscal Gaps

Requires Raising Taxes by Roughly 2, 3, 2, and 2 Percent of GDP,

Respectively, Immediately and Permanently

Note: These Values Appear Based on Highly Optimistic Projections

U.S. and UK Fiscal Policy Is Clearly Unsustainable

Closing the Fiscal Gap *Requires an **Immediate and Permanent** 40 Percent Tax Hike*

in the U.S. and a 28 Percent Tax Hike in the UK

And Waiting to Achieve Fiscal Sustainability Will Increase the Size of Required Adjustments

What Explains the Massive U.S. and UK Fiscal Gaps?

Aging Interacted with the Need to Pay High and Growing State Pension and Healthcare Benefits to the Elderly

The 65+ Share of the U.S. Population is 17%, Rising to 28% in 2100

The 65+ Share of the UK Population is 19%, Rising to 39% in 2100

S. Korea's Demographic Shockers

The 65+ Share of the S. Korean Population is 18%, Rising to 38% in 2100!

S. Korea's Fertility Rate is 0.81 – the Lowest in the World!

S. Korea's Population Will Decline 53% Through 2100 – From 51 Million to 24 Million!

How Large Is S. Korea's Fiscal Gap and What Tax Hikes
or Spending Cuts Are Needed to Close It?

Good Question!

As Far As I Know, No One Is Doing Fiscal Gap Accounting for S. Korea

There Is a 2018 IMF Study Entitled

“A New Strategy for S. Korea's Policy in a Low Growth Environment”

The Study's First Two Sentences

S. Korea Has an Impressive Track Record of Fiscal Prudence that Has Been a Key Contributor to Macroeconomic Stability.

*With a General Government Debt of 40 Percent of GDP ...,
S. Korea Has One of the Soundest Fiscal Positions of Advanced Economies.*

The Third Sentence

By 2060, S. Korea's Spending on Old-Age Pensions and Healthcare Will Be 10-16% Higher than Today

The First Two Sentences Tell Us Absolutely Nothing Given that the Debt Is Not Well Defined

The Third Sentence Suggests S. Korea Has a Massive Unreported Fiscal Gap

Conclusions

S. Korea Needs to Immediately Do Fiscal Gap and Generational Accounting

But These Are Partial Equilibrium Analyses that Don't Account for Uncertainty

Economists Can Now Build Large-Scale Life-Cycle Models
With Macro Shocks, Uncertain Demographic Change, and Fiscal Policy.

These Models Can Show S. Korea the Range of Outcomes Facing
Future Generations Based On Alternative Fiscal Policies

Conclusions

S. Korea Should Consider these Reforms If Not Already In Place

1. Dramatically Expand Immigration of High-Skilled Workers
2. Provide Financial Incentives for S. Korean Emigres to Return
3. Dramatically Raise Financial Rewards for Having Three or More Children
4. Reform Fiscal System to Provide Far Better Incentives to Work
5. Gradually Raise the Pension System's Earliest Retirement Age to 67
6. Provide an Active System of Retraining Retired Workers to Return to Work
7. Major, Sustained PR Campaign Promoting Having Children and Working Till 75