The Daily Dish

How Not To Grow And Prosper

DOUGLAS HOLTZ-EAKIN | JANUARY 14, 2020

Eakinomics: How Not To Grow And Prosper

Economics is not complicated. Combine capital and labor to produce output and generate income. Repeat. If you want more income per person – i.e., an improved standard of living – increase the amount of capital and combine with labor. Repeat.

How do you increase the amount of capital? Save. Put down that bag of Twizzlers (or can of Diet Coke, or lavish dinner at P.F. Chang's) and save the money. The financial markets will channel those savings to a firm that wants to purchase new equipment or expand its factory – the saving finances the increase in capital. Saving is the essential activity undergirding economic progress.

So, I found it distressing to read a recent column by Larry Summers arguing for less saving in the United States, facilitated by expanding government "social insurance" programs such as Social Security, Medicare, and other entitlements. I wholeheartedly disagree.

As he puts it, "a generous and well-functioning society in which Social Security meets retirement needs, appropriate unemployment and wage insurance programs cushion economic shocks, adequate public funding holds down college costs, and health insurance has generous coverage would greatly reduce the need for most households to save."

There are a lot of reasons to quibble in this single sentence. Social Security was never intended to be the sole source of retirement income. It was intended to supplement private saving and company pensions to provide insurance against the risk that one would outlive these primary sources of retirement income. Public funding of college is not insurance of any kind; it is a flat-out subsidy of college that will raise the demand for college and make college more (not less) expensive. Health insurance is increasingly not insurance: As chronic conditions account for the vast majority of health care costs, there is no uncertainty to insure against – it is just pre-paid health care. I could go on, but there is no reason to pretend that insurance risks are a justification for the expansion he is proposing.

He then makes a fundamental error. He notes: "Suppose the government expands Social Security by raising taxes on payrolls by, say, 2 percentage points and pays the proceeds to the retired generation, then continues this policy indefinitely. The generation currently retired would get a windfall gain. And each subsequent generation would earn a return on the taxes it pays equal to the *economy's growth rate, which is well above rates of interest* " (emphasis added).

This is true as far as it goes. The problem is that his prescription for a no-saving economy is a prescription for economic stagnation, a growth rate of the economy that falls below interest rates, and the windfall generation living well at the expense of the future of the country. No thanks.

There are also silly statements. "It is highly inefficient to rely on individual saving rather than universal public programs to deal with life's contingencies. Social Security, for example, pays out close to 99 percent of the revenue it collects in benefits. In contrast, individuals saving for retirement or the proverbial rainy day can over a lifetime dissipate as much as 20 percent of their savings in commission payments to financial institutions. Similar, and probably greater, efficiencies are associated with government provision of other forms of insurance."

The 20 percent did not dissipate! It became the income of someone else in the economy, and may very well have been saved as well. What matters in the end is the economy-wide capacity to save, invest, and grow.

The paucity of private pensions, a low household saving rate, and the unsustainable debt trajectory of the federal budget are well-documented. Twisting the economics to argue for more unsustainable federal debt and lower private savings is the wrong prescription for the economy.