The Economic Club of New York

114th Year
580th Meeting

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Webinar

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Introduction

Vice Chairman Michael O'Neill

Good afternoon and welcome to the 580th meeting of The Economic Club of New York in our 114th year. I'm Mike O'Neill, Vice Chair of the Club and am honored to be here with you today. As many of you know, The Economic Club of New York is one of the nation's leading nonpartisan forums for discussions on economic, social and political issues, and our mission is as important today as ever as we continue to bring people together as a catalyst for conversation and innovation.

I'd like to take a moment to recognize those of our 321 members of the Centennial Society joining us today as their contributions continue to be the financial backbone of support for the Club and help us to offer our diverse programming now and in the future. A friendly reminder, applications for The Economic Club of New York 2021 Class of Fellows – a select group of rising next-generation business thought leaders is still open. Please visit our website for more details. We'd like to welcome graduate students from Rutgers University, NYU Stern School of Business, the Gabelli School of Business at Fordham and the CUNY Graduate Center.

It's now an honor for me to introduce our special guests today, Jason Furman and Club member Larry Summers. Jason and Larry will discuss their new paper, "A

Reconsideration of Fiscal Policy in the Era of Low Interest Rates." Larry is the Charles W. Eliot University Professor and President Emeritus of Harvard University. He has served in a series of senior policy positions in Washington, D.C., including the 71st Secretary of the Treasury for President Clinton, Director of the National Economic Council for President Obama, and Vice President of Development Economics and Chief Economist at the World Bank.

He is currently the Charles W. Eliot University Professor at Harvard University and the Weil Director of the Mossavar-Rahmani Center for Business and Government at Harvard's Kennedy School.

Jason Furman is Professor of the Practice of Economic Policy jointly at the Harvard Kennedy School and the Department of Economics at Harvard University. He is also a nonresident senior fellow at the Peterson Institute for International Economics. This followed eight years as a top economic adviser to President Obama, including serving as the 28th Chairman of the Council of Economic Advisers from 2013 to 2017, acting as both President Obama's Chief Economist and a member of the cabinet.

Jason worked at both the Council of Economic Advisers and the National Economic Council during the Clinton administration and also at the World Bank. Jason was also a Director of the Hamilton Project and Senior Fellow at the Brookings Institution and also has served in visiting professorships at various universities.

The format today will be a conversation in which we are fortunate to have former Club Vice Chairman and Chairman of North Island and Co-Founder of Silver Lake, Glenn Hutchins, doing the honors. We will end promptly at 1:00 and any questions that were sent to the Club from members in advance were shared with Glenn. As a reminder, this conversation is on the record and we do have media on the line. Glenn, over to you.

Conversation with Lawrence H. Summers and Jason Furman

GLENN HUTCHINS: Thank you Mike. Jason and Larry, welcome. I'm thinking that this is probably the greatest collection of talent we've had at The Economic Club of New York perhaps since Bob Rubin appeared alone. So let's get to your paper first. As I read it, there are four key arguments in it and maybe we'll try to take each of those in turn. One is about the measure of fiscal stability; another is about growth-oriented policies rather than balanced budgets as a target. A third is about interest rate levels, and the fourth is about risks that come from kind of systematically low interest rates. So if you guys don't mind me sort of breaking it down into that kind of structure, let's take those, take them apart, each one by one.

Number one, you argue that the measure of fiscal stability should not be to raise your federal debt to GDP, which is misleading and leads to poor policy choices, but rather should be interest service as a percent of GDP. And in an era of low interest rates, that leads us to a very different conclusion than the level of debt might lead us to. Start first with that, if you would.

LAWRENCE H. SUMMERS: Glenn, think about the comparable situations for a household or a business. A household deciding whether to, how much debt to have would look at the value of the home against which that debt represented mortgage or would look at the share of income that the debt service payments would represent but would not naturally look at the ratio of debt to income. Similarly, a business might look at the ratio of debt to the market value of equity of a firm or it might look at the fraction of cash flow that was being absorbed by interest payments, but the ratio of debt to income would not be an especially natural measure of sustainability.

The same kind of logic applies with respect to thinking about public debt. We can measure a stock debt relative to another stock, the asset represented by the government's capacity to tax in the future, the present value of tax receipts, or we could look at the ratio of a flow, debt service, to annual receipts from taxes. Either of those comparisons are going to be very much affected by low interest rates, and in particular by low real interest rates. And so any reasonable analysis of sustainability in any context with respect to debt takes account of the level of interest rates. I'm not sure much science went into the design of the Maastricht criteria, but if any science had, that science would have been very much influenced by the fact that at the time the real interest rate in Germany was about 4%. In contrast today, the real interest rate in Germany is well below 1%. It's well below negative...

GLENN HUTCHINS: It's negative.

LAWRENCE H. SUMMERS: And so any analysis of sustainability in any financial context has to be attentive to the level of rates in a way that debt income ratios are not.

GLENN HUTCHINS: Jason, do you want to add to that?

JASON FURMAN: Yes, let me just add two points. We need to have fiscal sustainability. There's no debate that it's important to have fiscal sustainability. The really important question, though, that's not answered by the phrase fiscal sustainability is where do you want your fiscal sustainability to be? Do you want to level off at debt that's 25% of GDP, debt that's 100% of GDP, debt that's, you know, 500% of GDP? How do you pick that number that you're sustaining yourself around? And in order to effectively pick that number – and I don't think you can quite pick that number in some timeless sense – you need to look at everything Larry was talking about, the flow costs.

He talked about Maastricht. Let me just give you the example of the United States. Right now our debt is, not right now, 20 years ago our debt was about one-third of GDP. At the time, based on the best estimates of interest rates, growth rates, etc., if we had wanted to retire the debt, we would have needed to raise taxes or cut spending by about one-half of one percent of GDP. So a relatively small adjustment could have retired the debt.

Twenty years later, the debt is three times as large, it's 100% of the economy. But based on the latest forecast for interest rates and growth rates from the Social Security trustees, it would still only cost about one half of one percent of GDP in extra taxes or reduced spending to over time retire that debt. And so in some sense, 100% debt to GDP today is about the same as what 35% debt to GDP ratio was 20 years ago. And it's this type of input that you need to think about when you think about sustaining yourself in a fiscal sense, where you want to sustain yourself and how worried you are about whether you need to do it in a better or worse place than where you are right now.

GLENN HUTCHINS: So I'm a little bit confused because it's probably I don't understand this as well as you guys do, but, Larry, I think said that, you know, you don't want to compare debt to GDP because it's a stock versus a flow. And you've used language of debt to GDP to explain these policies. So I'm curious what the right metric to use is, what's the measure of wealth to which we should compare our debt for purposes of understanding it better?

JASON FURMAN: So I think you could, in the example I just gave I did something, this isn't what I do because there's a huge amount of uncertainty in the way you measure it, but I just gave you the debt, which right now is about $20 trillion and I divided it by the present value of U.S. GDP, which, you know, who knows what it is, but the Social Security trustees think it's about $4 quadrillion. I don't know if you've ever used the word quadrillion.

GLENN HUTCHINS: So you think that's sort of the right number, the present value...

JASON FURMAN: That's one way to do it. Alternatively, and I think this is probably the better way and this is what we do more to recommend in our paper, would be to do a flow-flow comparison. How much do you have to pay in interest this year? What's your income this year? And both of those are very well defined and easy to measure concepts.

GLENN HUTCHINS: I get that, but I think skeptics are kind of more, would like also the stock-stock, and that's what you're saying, the right stock to measure debt to what would be the present value of GDP.

LAWRENCE H. SUMMERS: Look, look, the simple point would be if you're going to do any kind of stock-stock, the stock presumably has to do with income today and income in the future discounted back to today.

GLENN HUTCHINS: Right. A discounted cash flow equivalent...

LAWRENCE H. SUMMERS: And you have to use, you have to take account of the fact that the interest rate has gone way down.

GLENN HUTCHINS: Right. We'll come back to that.

LAWRENCE H. SUMMERS: ...stock analysis. You actually have, you get into some logical problems because the growth rate is, the expected growth rate of the American economy is substantially greater than the interest rate. And so if you do that stock calculation in an overly literal way, you get infinity, which isn't so helpful.

JASON FURMAN: But it would be good.

LAWRENCE H. SUMMERS: And that's why we would fall back to using the flow-flow measure. But the fundamentally right way to think is either to compare flows with flows or to compare stock with stocks. And it is also true, and I think this is what Jason was acknowledging, that it's not our belief that a path where the debt to GDP ratio is always going up – from here to infinity – is likely to be a viable path. But consistent application of logic around comparing flows with flows or stocks with stocks would avoid a debt to GDP flow ratio that would go up without that.

GLENN HUTCHINS: Gotcha. Okay, all right, good. So let's switch to part of this, number two, which is you guys advocate that we should aim for growth-oriented policies, not balanced budgets. That's the logical consequence of this argument. And that you "reject traditional ideas of cyclically balanced budgets" and think that fiscal policies should be "to advance", the goal should be "to advance economic growth and financial stability." You have three guidelines you suggest for success. I won't repeat those here. I'll let you guys get into them. But talk about this implication, this key implication of the argument that we've just been talking about.

JASON FURMAN: So maybe I'll go first this time, Larry, and when we get to interest rates next, you'll want to go first. So, yes, Glenn, I mean the point of this is not a green-eyeshade exercise. It's what type of economy we want to build. Fiscal policy plays two really important roles in growth. One is when the economy is operating below its potential. It acts as fiscal stimulus and helps get you back closer to that potential. That fiscal stimulus is especially powerful in an economy where interest rates are stuck at zero. There's less the Federal Reserve can do and the fiscal measures are less likely to be crowded out.

The second thing is that fiscal policy operates on the supply side of the economy – investing in infrastructure, in research, in education, in children and all sorts of things that expand our productive capacity. Low interest rates make both of those policies more favorable. As I said, on the demand side stimulus, it means you're less likely to have crowd-out and you're more likely to have a situation where your fiscal expansion actually reduces your debt to GDP ratio because it raises GDP by more than it raises the debt. That's something that Larry found in a paper. That's something that the OECD and the IMF have also found in their modeling and you see it in the Federal Reserve models.

Similarly, on the supply side a lot of what you're talking, on infrastructure, education, research, all is a cost today in order to get a benefit in the future. When interest rates are lower, that benefit in the future is more valuable. The present discounted value of it is higher. Thought of another way, if the cost of capital to the government is effectively zero, you want to invest in ideas that are better than nothing and there's an awful lot of those that are better than nothing.

And so what we propose is that, yes, if it's something like, you know, you're giving out pension payments to the elderly and that has very little growth rationale directly, you should pay for that. But if you're talking about something that's growth-oriented, whether it's fiscal stimulus in the short run or expanding the supply side of the economy in the long run, low interest rates, the metrics we're talking about mean we want to give very substantial latitude to those and make sure we're not making the mistake we've often made in the past of under-doing it in response to crises and under-investing, instead setting the dial to be more aggressive in both of those areas.

GLENN HUTCHINS: And I assume you're referencing a little bit – Larry, give me one second – sort of the premature tightening post-The Great Financial Crisis ten years ago.

JASON FURMAN: Right, the premature tightening post-financial crisis and also the chronic underinvestment in infrastructure, education and the like. There's an important paper by colleagues of ours at Harvard – Nathan Hendren and Ben Sprung-Keyser – we talk about in our paper where they go through dozens and dozens of social programs and track the long run evidence. You know you give education to a child today. You track them 25 years from now. They make more money. They pay more in taxes. That program ends up paying itself back. This isn't some hand waving, supply side, things pay for themselves, this is in one of the leading journals in economics, The Quarterly Journal of Economics, reviewing over a hundred other studies, many of which had this feature.

GLENN HUTCHINS: Larry...

LAWRENCE H. SUMMERS: I'm just going to say what Jason said in a slightly different way. As between two overly simplified shibboleths. Shibboleth-1, debt is bad. And shibboleth-2, it's good to borrow if you invest the proceeds in something that has a return much higher than the interest rate at which you borrowed. I think the second is the better shibboleth. And I think we've been overly guided as a country by the first shibboleth in thinking about government budget policy.

When I think about the burden that we're leaving to the grandchildren – I hope to have -generation, I am much less worried about a bunch of paper debt in a currency we print ourselves that currently carries an interest rate of negative-100 basis points...

GLENN HUTCHINS: Real interest rate.

LAWRENCE H. SUMMERS: What's that?

GLENN HUTCHINS: Real interest rate.

LAWRENCE H. SUMMERS: Yes, real interest rate of negative-100 basis points, than I am worried about deferred maintenance on projects where the cost of the maintenance compounds at 8 or 10% a year as it grows. Much less worried about the accumulation of paper debt than a denuded civil service that's not competent to implement basic public functions. Much less worried about paper debt at negative real interest rates than an infrastructure that's not able to accommodate the demands that will be placed on it 25 years ago.

So it seems to me we need to take a broad view of all of this, that low interest rates are telling us something about the risk-adjusted return on private investment, that it's lower than it used to be, that no important private investment project is today being constrained by the cost of capital. And that we need instead to focus on the various high return public investment projects that are available, some of which are so productive that they actually pay for themselves in terms of the government budget even though the government is only taking a portion – perhaps it's 25% share in the economy – of the benefits of those projects and that we need to take a much broader view where we look at debt and investment. That doesn't justify all kinds of borrowing but it does justify borrowing for investment.

GLENN HUTCHINS: Okay, good, thank you. So the next two arguments that you make have to do with interest rates. The first is kind of, they're low, and you would expect a persistently low level. And the second is kind of policy risk interaction. Let's start with the first. Talk a little bit about the key assumption here about the level of interest rates and its persistence. I would point out, Larry, these two arguments are consistent with the secular stagnation argument you've been making for years now. And so you're not new to this kind of point of view, just for this moment of interest rates. So let's address that one first.

LAWRENCE H. SUMMERS: So, first of all, we have the capacity today to borrow for 30 years at negative real interest rates. So if you borrow long at locked-in negative real rates, or we borrow long at very low nominal rates and have the capacity to create extra inflation, then it doesn't really matter what happens to the interest rate path going forward. We have locked in the cost over the longer term.

Second, we can't know, and don't know what the path of interest rates are going to be. I think it's informative to look at what markets think. And markets provide estimates, not just of the expected future interest rate, but using options, of the whole distribution of interest rates. And those options suggest that the odds are more than 80% that five years from now the 10-year interest rate will be below 2.8%. So markets are assigning a quite low probability to a spike in interest rates.

Third, Jason and I would be the first to recognize that we don't know the future and that policy may need to adapt. My judgment, which I won't elaborate on now, is that there are a whole set of fundamental factors that have led to increases in the propensity to save and reductions in desired physical investment that constitute deep structural reasons why real interest rates are going to be low for a long time to come. I could turn out to be wrong. If I do turn out to be wrong, the application of the kind of criteria that Jason and I have suggested would be that we would need to take actions down the road that operated in the direction of either raising revenues or reducing spending.

And the magnitude of those adjustments, even if interest rates were to spike by 200 basis points, are really quite small compared to the history of adjustments that countries have gone through at moments of substantial fiscal problems. And so, in sum, we can lock in the lower longer rates. It's unlikely in the judgment of markets that rates will spike enormously and if they do there will be scope for adjustment at that time.

In contrast, if we are to obsess about the interest rate concern, we run the risk of austerity that diminishes growth, ultimately leads to bigger deficits at higher debt, as well as all the various social, economic and political problems associated with higher unemployment.

GLENN HUTCHINS: We'll come back a little bit to some of the implications in the next piece of this, but Jason, did you want to jump into this piece about the level, the expected level of interest rates? Real interest rates.

JASON FURMAN: Yes, just sort of two things to say. Larry introduced the term secular stagnation about five years ago. He was very powerful in focusing people's minds on this debate. But I think what many misunderstood, Larry didn't misunderstand it, but many misunderstood – secular stagnation didn't say we're going to have slow growth. In fact, it didn't even say that the problem it was identifying was inevitable. It said interest rates are lower. That's a challenge for monetary policy. It makes it harder to do and more financial instability associated with it, but it's an opportunity for fiscal policy.

And if you do the right things on fiscal policy, you can – in effect – solve secular stagnation, bring back a better balance where you can use both fiscal and monetary policy and it actually gives you an opportunity to make more public investments in the future, in part because secular stagnation is telling you the return to private investment has gone down so much, it doesn't really give you any information about it. So I think moving, you know, to some degree away from the term secular stagnation or a better understanding of it as a solvable problem about interest rates as opposed to an insolvable problem about growth.

The second thing I would stress, again going back to the, no one is calling for permanent increases in debt or unbounded amounts of debt. When we do the different forecasts we do for the U.S. fiscal trajectory, we use the Congressional Budget Office assumptions. They have interest rates, the 10-year rising to 3% by 2030. As Larry said, financial markets think that's too high an interest rate. So I think, if anything, the interest rate forecast – and maybe this is cheating in answering your next question, Glenn – the interest rate forecast we're using, I think, is more likely to have interest rates that are higher than we're going to have rather than lower. And certainly no one is assuming interest rates are staying where they are right now in projecting forward.

We also adopt a standard that we should keep interest payments adjusted for inflation below 2% of GDP. That's something they've been historically often. It's been comfortable when that's happened. And under the scenarios that we're talking about, not only do we assume interest rates rise – and they rise faster than markets think they're going to rise – we also stay well below, for many decades, that threshold that we're comfortable with. So there's a certain conservatism built in to these assumptions as opposed to, you know, an over-optimism about low interest rates. I think we're more likely to be pleasantly surprised than the opposite. Either way, though, we can't just set it and forget it. We need to keep making adjustments.

GLENN HUTCHINS: We'll come back to some of that.

LAWRENCE H. SUMMERS: Glenn, can I just...I think Jason had it exactly right when he highlighted that secular stagnation was a characterization of a certain relationship between private savings and investment, not a fatalistic forecast of a fatal outcome for the economy. And I think the right way to think about this is that if the macroeconomic problem for the last, for the 30 years from 1980 to 2010 was excessive inflation and excessive crowding-out of private investment, the macroeconomic problem for the next decade will be savings absorption. It will be absorbing the substantial level of savings generated by the private sector with productive investment.

And the canonical example is our leading technology companies like Apple or Google, for whom the fundamental business problem is absorbing all the cash flow that they generate in a productive way. And when that is the canonical problem for leading growth companies, that is telling you something about the nature of the era that we are in. And so a focus on managing the savings absorption process is, I think, the right way to conceptualize the macroeconomic challenge, which is very different from the way the macroeconomic challenge was conceptualized in the wake of the Carter inflation.

GLENN HUTCHINS: So let's get to the fourth piece of the argument. And, of course, since these arguments are all interwoven, we've touched pieces of them. I just want to make sure we get the full thing out here before we move on to some of the questions. And the fourth involves the interest rates, that interest rates, what I would say, carry their own risks, like encouraging excessive leverage and financial instability before The Great Financial Crisis, limiting the ability of central banks to respond to economic slowdowns, putting more burden on fiscal policy, etc. And so you make the argument the healthiest way to reduce deficits today is to boost the economy. Is there any other pieces of this part of the argument that we haven't touched on yet that we should? Do you guys want to wrap it up before we move on to questions?

LAWRENCE H. SUMMERS: I guess what I would just say quickly, Glenn, is that I'd put it back to that savings absorption problem. If you have high savings and you don't have productive private investment opportunities, the savings will channel themselves into the existing assets which will lead to inflated asset values, which carry risks of financial instability, strong temptation to private sector leverage, and to the perpetuation of unsound enterprises, all of which are not desirable.

I mean, go back to the 2008 crisis. The 2008 crisis had its roots in excessive liquidity and asset price bubbles. But why did we have excessive liquidity that led to those asset price bubbles? Not because people were stupid and just created it for the sake of it, but because the Fed was determined to drive the economy back to full employment, was confronting inflation that was below target levels and therefore found itself easing monetary policies and that then set the stage for the financial crisis. If we want to avoid those kinds of dilemmas in the future, we have to create structures that enable full employment without those kinds of excessive liquidity.

GLENN HUTCHINS: Okay, so let's do a transition now to a couple of questions that arise from this issue of kind of persistently low interest rates as a key assumption. I'm sure you guys read the piece by Rubin, Orszag, and Stiglitz recently where they said and I quote, "while low interest rates change the contours of the fiscal debate, they should not be assumed to persist forever. While it is reasonable to expect low rates continuing for some time as a central forecast, we have less conviction than some that the era of low interest rates will remain a permanent feature of the environment. In our collective experience, fiscal policy should instead be informed by copious amounts of humility."

So let's talk a little bit about sort of our confidence in these interest rates persisting low for a meaningful period of time. First of all...go ahead, you guys want to respond to that directly.

JASON FURMAN: One, the fact that you don't know what's going to happen in the future doesn't obviously tell you, you want to do more deficit reduction, you want to do less deficit reduction, etc. Everyone's uncertain, first of all. Second of all, you know, I think you do want to build some prudence into all of this. And by assuming the CBO path for interest rates, we're assuming a path for interest rates where I think it is more likely that interest rates will be below what we're assuming than above what we're assuming.

Third, you have to ask yourself, what is the cost of making an error and adjusting too quickly now. And that cost might be that you miss out on investments and infrastructure and research, education, and so we're poorer ten or twenty years from now. And then conversely you have to ask yourself, what is the cost of waiting and acting later? And if we're talking about is an adjustment on the order of, you know, half a percent of GDP, 1% of GDP, 2% of GDP, that's something a lot of countries, and for some of those numbers, the United States as well have done.

Often, there's actually a literature in economics on investment under uncertainty. And what it finds is if you have a large irreversible decision, that more uncertainty actually should lead you to delay a little bit more making that decision as you collect, you know, more information. And so the idea that we would rush off and embark on deficit reduction, a pivot to austerity, bringing down our debt to GDP, just because there's a forecast that maybe interest rates are higher than markets or any forecasters think, I think – if anything – is the less humble attitude. Right now, sort of work with where you are and then make adjustments as needed.

LAWRENCE H. SUMMERS: Can I just answer? I would say two other things, two things about that. First, I'd rather go with markets than with anybody's opinion. And we're going with a way conservative view relative to what's in markets. Second, I have to say that being lectured about the need for fiscal humility by a bunch of people in the top 1%

of the income distribution who have advocated slashing the benefits of Social Security recipients – none of whom receive more than $40,000 in income – in order to pursue their best guesses as to what will work out best seems a rather odd picture. It seems to me that people who are lacking in humility are the people who are proposing to impose substantial economic pain on people much poorer than theirs based on their opinions that differ from the opinions that are baked into markets. So I have a rather different view as to what constitutes the humble posture here.

GLENN HUTCHINS: Okay, so on this issue of interest rates and markets, our Club member, Lee Cooperman, has submitted a series of questions while we've been talking. Let me see if I can summarize them as we're talking. He raised an issue which I wanted to raise too about the average maturity of the existing U.S. government debt, the terms-structure question because if interest rates do go up, how do you adjust to that? So do you believe in the capital market line and what do present interest rates suggest for common stock returns going forward? Should the government issue 100-year bonds or stick with main overnight financing? Are you comfortable that bonds will continue to be bought despite offering negative returns after taxes and inflation?

LAWRENCE H. SUMMERS: I'm pretty confident that bonds will continue to be bought and that interest rates will fluctuate. I am unenthusiastic in the extreme about 100-year bonds because of the convexity aspects that would cause their issuance to represent a major boom to the hedge fund industry and fixed-income trading desks at the cost of treasuries.

The question of the maturity structure of the debt is a complicated one because what one cares about is the structure of the debt that has to be held by the public. And that reflects both the debt that the government issues and the debt that the Federal Reserve buys. In general, I would prefer more of the debt that's held by the public to be longer term for financial stability reasons, for locking in the lower rates. But that goes to both questions related to QE and questions related to the government's debt structure.

And I think we exist frankly in a world of some confusion on this in the United States and have for the last decade with the simultaneously – the Treasury proudly explaining that it's terming out the debt to lock in low rates and the Fed proudly explaining that it's purchasing long-term debt in order to bring down long-term rates and provide expansionary pressure to the economy. And I think we would be better off with a common debt management policy that sensibly balances those objectives, which in my view would probably be a policy that caused the debt the markets had to buy to be trending towards being longer term for as long as rates remain where they are today.

JASON FURMAN: You also asked about how somebody could afford to retire at the low return on savings. And, you know, three responses to that. First of all, the rate of return to savings has fallen, not because of any choices that the government has, not mostly because of any choices the government has made, but because there's a worldwide, you know, increase in the supply of saving, for example, greater inequality, people want to save more, reduction in the demand for it, and that's lowered the rate of return. The second point would be if we did more expansionary fiscal policy, it would actually help. That would drive up interest rates, drive up the rate of return, and put less pressure on monetary policy to keep rates lower. So, if anything, this is part of solving your problem.

GLENN HUTCHINS: A virtuous cycle.

JASON FURMAN: Yes. Third, and most directly, is the rate of return that you get in market is the interest rate or the interest rate plus some extra premium associated for risk. The rate of return you get on a pay-as-you-go Social Security system is the growth of the economy. And right now with the growth of the economy being higher than interest rates and with interest rates falling more than the growth rate has fallen, that's a really good argument that part of how we want to ensure retirement security is not just with saving, but with Social Security. So at the very least, don't cut benefits for the majority of Social Security beneficiaries and, in fact, raise benefits. You'd have to put more in, in the form of payroll taxes to get more out, but that actually has a comparatively higher rate of return to private saving in the current environment, and it would also help increase demand in the economy and address some of the secular stagnation problems we've talked about without raising budget deficits.

LAWRENCE H. SUMMERS: Glenn, if you'll indulge me...

GLENN HUTCHINS: Do I have a choice? (Laughter)

LAWRENCE H. SUMMERS: Of course you do. You paid for this microphone, so to speak, so of course you do. Jason's last point brings to mind what I think of as one of the major points of our paper, which you didn't highlight in your very good questions, which is many people think expansionary fiscal policy and a bigger government budget deficit are the same thing. They're not. Fiscal policy can be expansionary without changing the government budget deficit in three kinds of ways.

One, by providing transfers from the young to the old through pay-as-you-go social insurance. That's what Jason talked about. It can provide higher return asset in effect for people than the market and at the same time reduce private saving because people know that they're going to get public pensions. Second, by providing stronger social insurance that reduces people's need to self-insure, people can make it possible for there to be more consumption demand in the economy. And third, successful redistribution from the rich, from those with high savings propensity, heavily more affluent, to those with a higher spending propensity, those with lower and middle incomes can also operate to increase stimulus.

So the goal here of more expansionary fiscal policy, a better-balanced economy with higher neutral interest rates can be achieved through larger budget deficits but not only through larger budget deficits, but also through the adjustment of the composition of fiscal policy.

GLENN HUTCHINS: Before we, I want to make sure we have some time at the end here to talk about the future-looking Biden administration type of policy recommendations, but a couple more on this very, I think, valuable and provocative paper you guys have done. Congratulations, by the way.

You say that if we get interest rates wrong, I think I heard you say this – this probably might be oversimplifying what you said, but that if we get interest rates wrong, we can always raise taxes. If rates go up, we have more deficits than we can support, we can always raise taxes. I think that's economically...sorry...

JASON FURMAN: Or you can cut spending if you want to.

GLENN HUTCHINS: Right. But two things. One is if that's likely to happen, if you get an interest rate spike that's likely to happen in the context of a crisis, and the question is, I would imagine during that time period neither of you would be suggesting increasing taxes or cutting spending into a crisis. And even if you did suggest it as a manner of economic policy, politically it would be very hard to do. So practically, how realistic at a practical level is that as kind of a trap door in case you get it wrong?

LAWRENCE H. SUMMERS: I think what we would probably both be suggesting is that we put fiscal policy on a trajectory that was preventing the larger burdens on the economy that were coming from the rising interest rates. I think that's a very remote scenario but I think that if we really were to have such a crisis, the evidence of the response to the CARES Act, the evidence of the responses in 2009 where things that were incredibly unpopular were legislated in terms of the TARP program, I think there's every reason to believe that as between letting everything spiral downwards as interest rates somehow skyrocketed with nobody doing anything and taking some kind of action, I would assume that action would very likely be taken.

But again, I think the risks here are really pretty remote and there's essentially no example in the last 40 years of a country with a low inflation tradition that has its own currency and its own central bank experiencing any spike of the kind that is being described. So I think the risks of a kind of lurching crisis of this kind are very remote and I think they actually could be managed. Of all the things that Americans should stay up at night worrying about today and for the foreseeable future, some kind of descent into hyperinflation seems to me to be awfully near the bottom of the list.

And it seems to be that Greece, which is sometimes invoked as a comparison, is much more similar in the nature of its situation to Illinois than it is to the situation of the United States in that it doesn't have a central bank that can stand behind its debt and is therefore susceptible to a run in a way that a country with a central bank and a floating currency is not.

GLENN HUTCHINS: So one last question on this topic before we get into more topical, current things. So how did – and I'm oversimplifying it – what did Rogoff and Reinhart get wrong with their work on "Growth in the Time of Debt" and does this mean that Bowles-Simpson was fundamentally wrongheaded?

JASON FURMAN: So Rogoff and Reinhart, first of all, it's notable that in the current environment they're pushing for, you know, a lot more debt. So there's no debate with them at all right now. First of all, they made a spreadsheet error so some of their results just didn't follow from the numbers they put in. Even absent that error, they were talking about a correlation. And so you observe economies that have a difficult time economically end up with more debt, that doesn't mean the more debt caused the difficult economic time and they didn't really try to disentangle that.

They also tried to pick a threshold and there's no evidence for a threshold. Yes, for every point the debt goes up, interest rates go up a little bit. That's reasonable. But no one else has ever found that there's some threshold. And then obviously the threshold they identified, 90%, lots and lots of countries have now gone through that threshold and you haven't observed anything like what was predicted there. That paper wasn't in a peer-reviewed journal. I don't even know how far they say that they'd want to push it now, and I don't think it really showed much of anything.

GLENN HUTCHINS: So was Bowles-Simpson wrongheaded, Larry?

JASON FURMAN: Yes, Larry can do that.

LAWRENCE H. SUMMERS: If Bowles-Simpson had been implemented as it was proposed and there had not been offsetting fiscal actions in the next six years, every econometric model of valuation suggests that the economy would have been far weaker over the decade than it turned out to be. The analysis is very simple. Bowles-Simpson would have taken 5% of demand out of the economy, conservatively 5% of GDP. In normal times, if you have a fiscal contraction, monetary policy lowers interest rates and that offsets the fiscal contraction. That's what happened with the very successful Clinton-Rubin deficit reduction program in 1993.

The problem is, and this is the essence of the secular stagnation argument, that interest rates were already very close to the floor through most of the period after Bowles-Simpson. And so there would have been essentially no room for the Fed to offset the major contractionary shock that it would have represented. So I don't think there can be any serious challenge to the view that economic performance over the 2010 to 2012 to 2018 period would have been substantially weaker if Bowles-Simpson had been enacted. To believe otherwise, one has to believe, one has to ask where would the demand come from? Households would have lower income and would be spending less. There wouldn't have been room for interest rates to have been much lower. So where would the demand have come from? Inflation would have been even lower which would have meant even higher real interest rates.

So I think it's pretty clear. Now if Bowles-Simpson had been enacted, perhaps it would have been un-enacted as the recession started and so something else would have happened. But I think it's absolutely clear, in retrospect, that Bowles-Simpson was not enacted, none of the things that were forecast would take place, none of the disasters that, for example, were forecast by two of the authors of the Rubin-Orszag-Stiglitz paper took place. In fact, we had what would have been regarded as substantially more fiscal irresponsibility after that, particularly in 2017. None of what was feared took place and the economy did not overheat. And so it's hard to see how if it had been enacted the results would not have been worse.

GLENN HUTCHINS: So we're running out of time here so we'll have to have you guys back at some point to get deeper into your recommendations for Biden economic policy, but we have about five more minutes. So in the lightening round of this, why don't you give us your thoughts about economic policy prescriptions for the future, maybe with a little bit of emphasis less on what you do for stimulus because the stimulus plan is out there right now, or relief, and more of what you might do next if they had an opportunity to pivot to, you know, more fundamental investments? In the context of our colleague, our Club member, Alan Murray's question, given the endless potential of government investments, how do you create enforceable political discipline around the investment process? So what would you do next?

JASON FURMAN: I think we're doing a lot of dollars for 2021. This is the year I'm least worried about demand in the last decade. I think supporting the economy and growing the economy on a sustained basis for multiple years after 2021 is the priority. To answer Alan's question – and Larry and I might prioritize these differently – my number one priority is almost anything that involves investing in children, whether it's childcare, preschool, nutrition and the like, I think that has very high long run returns, probably more than enough to pay for itself. I'm not worried about undisciplined overinvestment in children.

Second, I would do research. Research is not a huge part of the budget so you're not talking about a huge expenditure. And a close third would be infrastructure, both traditional infrastructure on the green side. And, yeah, you need good government. You need to ask, you know, can you spend this much money? If somebody's proposing to increase something 20-fold tomorrow, probably you're not going to be able to spend that well. If they're proposing, look at the details, does it make sense? Is this the right amount of money, etc.? But I don't look around and see a lot of white elephants in American infrastructure. I look around and see a lot of unmet needs.

GLENN HUTCHINS: Larry...

LAWRENCE H. SUMMERS: I am less worried about policing the boundaries of what constitutes investment than I am about choices to spend very heavily on payments that by no possible stretch of the imagination represent an investment. I am worried about the, exactly what Jason's worried about, the scale of the 2021 spending, which would increase disposable income, total household income, and increase, I'm confident household income in every quintile by more than 10% above what it would have been if Covid had never taken place. So that it's far more than replacement for Covid losses on the most generous definition. That seems to me the lower priority than ongoing strong investment over the course of the next decade. It may be that we can have both. And if so, that might be ideal. But I don't think that the pressing problem of the economy in 2021 is lack of demand. And I do think that the secular stagnation issue is going to loom before us for savings absorption problem issues for a long time to come. And so I think of this as the first move in a long chess game and it will be hard to evaluate that first move without seeing how the rest of the chess game plays out.

GLENN HUTCHINS: Larry, Jason, thank you for joining us today. I hope you come back sometime. It was stimulating and very interesting. Mike, I'll turn it over to you to close us out.

VICE CHAIRMAN MICHAEL O'NEILL: Thank you gentlemen, very, very interesting and insightful discussion. I'm pleased to report that we've got a number of other great speakers lined up. And as always, we encourage you to invite guests to our events. In the next month we'll be hosting Garry Kasparov, Russian Pro-Democracy leader and former world chess champion, Jay Powell, Adena Friedman, Peter Orszag, Bob Rubin and Joe Stiglitz, and Mark Tessier-Lavigne, President of Stanford University, Mary Daly, President and CEO of the Federal Reserve Bank of San Francisco on March 2. So plenty of interesting topics. Thank you again for joining us.