

NBER Panel Discussion: Implications of COVID-19 for Social Security

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Outline

What drives economic assumptions usually and how should COVID change that?

Perspectives from being a member of Technical Panel

How does COVID affect my view on some of the assumptions?

Labor Share

Productivity

Interest Rates

I have similar views—but won't discuss— trends in labor force participation.

What are implications of the changes in the economy for social security policy?

The Framing of the Projections

Two sets: near-term (first 10 years); long-term (last 65 years)

Because projections are done for 75 years, argument made is that you should use long-run historical averages as guide to long-run assumptions.

In practice, first few years reflect current data, but then transition to long-run values.

Most of the first ten years largely a function of the gap between current values and long-run values.

The long-run assumptions “drive” the projections.

Is the Long-run Important?

I think focus on 75 years is misplaced.

From policy and political perspective, important #s are for the next 10 -15 years.

- Demographic transition over by 2035.
- HI trust fund depleted within next 6 years; OASDI by 2035 pre-COVID.
- Getting the next 10-15 years right the most important part of the projection.

How is this related to COVID?

COVID could easily affect next ten years, but not very likely to have large long-run effects.

Focus on long-run could mean that many near-term effects ignored.

The Labor Share

Labor share declined through early 1980s, generally well below 1947-2018 average since.

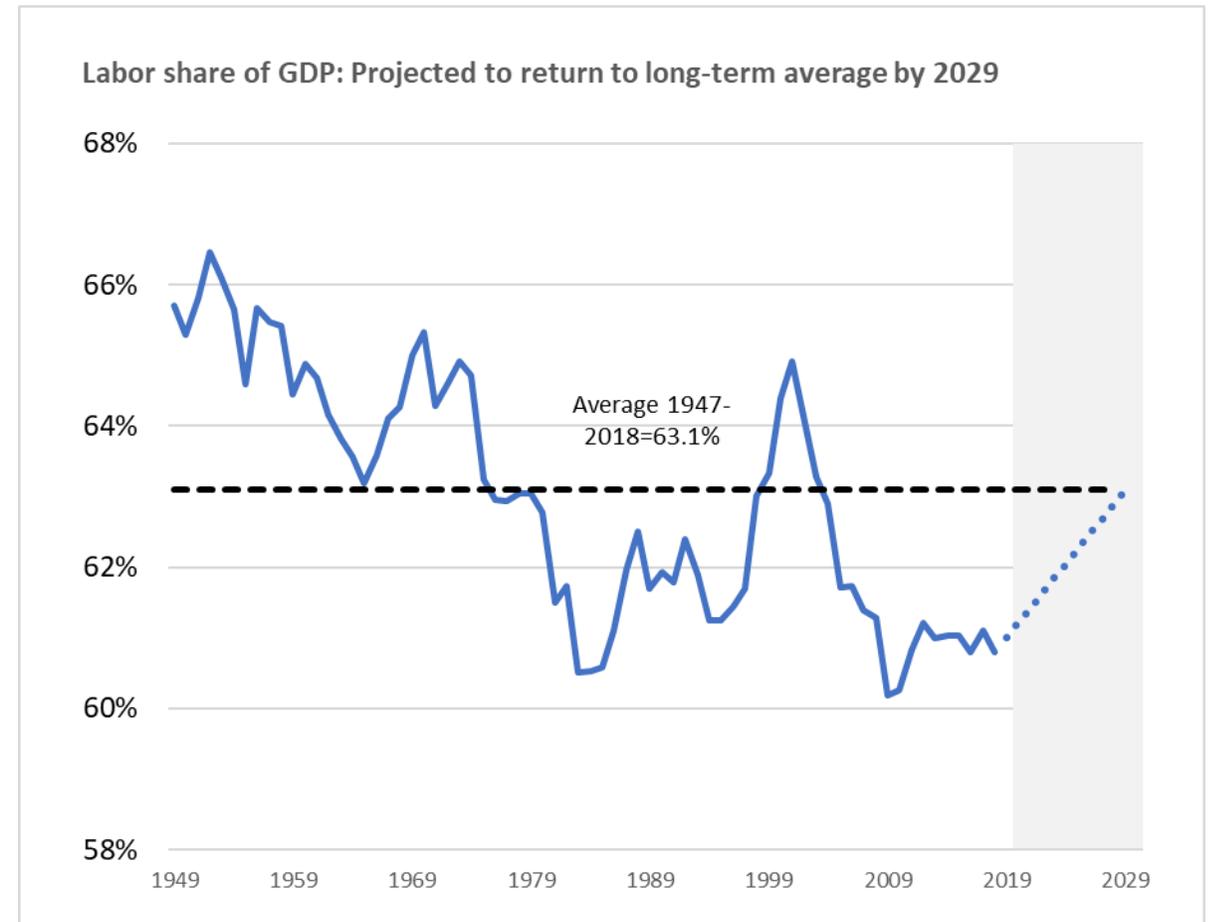
Globalization, higher depreciation, higher housing share, decline in worker power—can explain decline.

These seem likely to persist, at least for a while.

But SSA has sharp increases in the labor share over next ten years to get back to long-run average.

How will COVID affect the labor share?

With high level of stock market and unemployment, likely that share will stay lower for longer.



Productivity Growth

Weak productivity growth over past decade.

Trustees assumes it rises back almost to long-run average over next 5 years.

Seemed optimistic before, no weight on the secular stagnation hypothesis or other structural explanations (aging).

What effect will COVID have on productivity?

In the long-run, probably little to none. Perhaps some reduction from increase in pandemic preparedness.

Over next 10-15 years, effects could be substantial.

- Business closures means large costs to start up again.
- Job losses means quality of labor matches likely to suffer temporarily, and firm-specific capital lost.
- Prolonged period of lock-downs/working from home/uncertainty—may be stifling innovation.

Again, important to model next 15 years, not let long-run drive projections.



Interest Rates

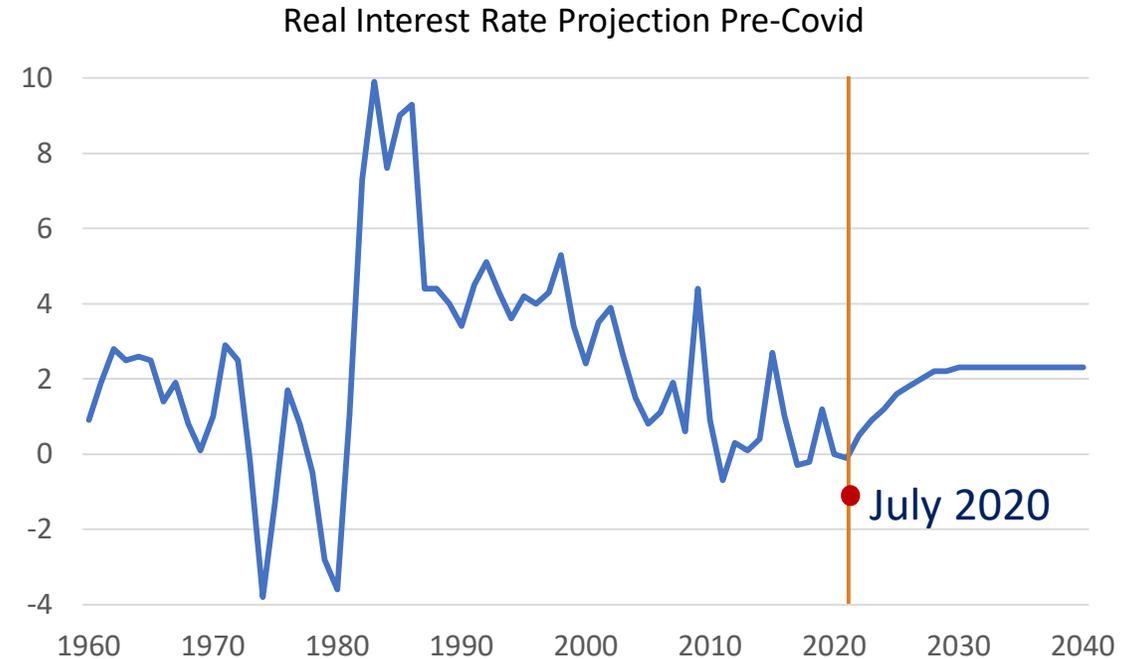
Real interest rates declining for decades, averaged just 0.5% from 2010-2019.

Aging, rising inequality, low productivity likely contributors.

SSA recently lowered its interest rate to 2.3%. Reasonable long-run assumption, but rapid increase over ten years seems unlikely.

Interest rates have fallen sharply as a result of COVID. Possibility of low-for-long seems even more likely.

Probability that $r < g$ high before and higher now.



Implications of COVID for Social Security Policy

Action to address imbalances in Social Security, increases in federal deficit will be needed eventually.

COVID has likely sped up the date of reserve depletion and likely increased the changes required to address long-run imbalances.

But doesn't necessarily mean that we should act sooner rather than later because of COVID.

Why?

- (1) Ensuring economic recovery is complete.
- (2) Reserves costly when $r < g$.

Ensuring Full Economic Recovery

Under current law—no additional stimulus \$ but also with no “second” wave—CBO projects GDP won’t be back to pre-COVID baseline for almost a decade.

Fiscal policy should aim to get back to hot labor market at the onset of the pandemic.

- Hot labor market particularly helpful for low-income working age households, leading to both higher GDP and lower inequality.

With debt to GDP projected to hit 108% or higher by 2021 and with reserve depletion looming for Medicare and Social Security, pressure to cut spending and raises taxes.

Debt reduction before back to strong economy self-defeating for long-run economic (and Social Security) health.

So COVID economy should lead action on Social Security to be delayed, unless the action is to transfer general revenues or to announce plans for the future.

Implications of $r < g$

Another reason often mentioned for acting sooner rather than later is because delay imposes costs on future generations.

From 2020 Trustees' Report: "If substantial actions are deferred for several years, the changes necessary to maintain Social Security solvency would be concentrated on fewer years and fewer generations. Significantly larger changes would be necessary if action is deferred until the combined trust fund reserves become depleted in 2035."

If $r < g$ over the long-run, everyone better off if allow reserves to exhaust and just run a pay-as-you-go scheme.

Ran a simple simulation using two interest rates (high and low) comparing:

- (1) Act now and require reserves at end of simulation to cover costs for one year.
- (2) Deplete reserves and then run pay-as-you-go scheme.

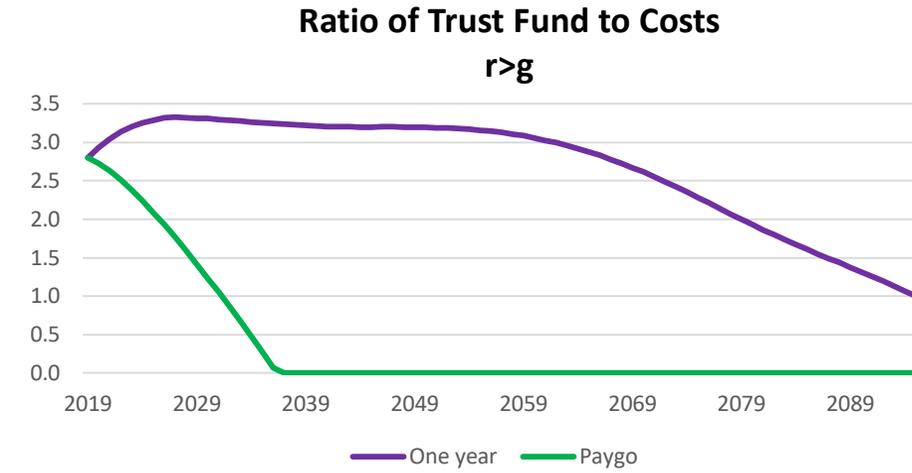
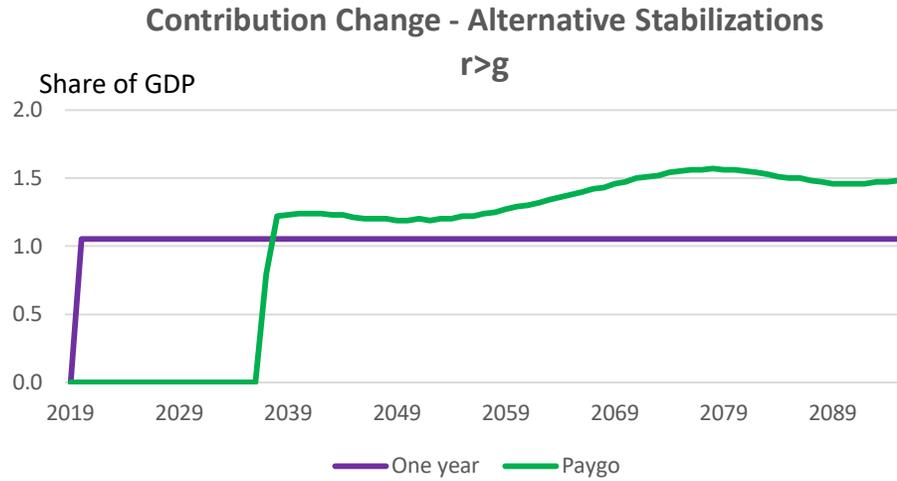
Illustrative Simulations:

Use SSA GDP, Income, and Costs (average nominal GDP growth 4%)

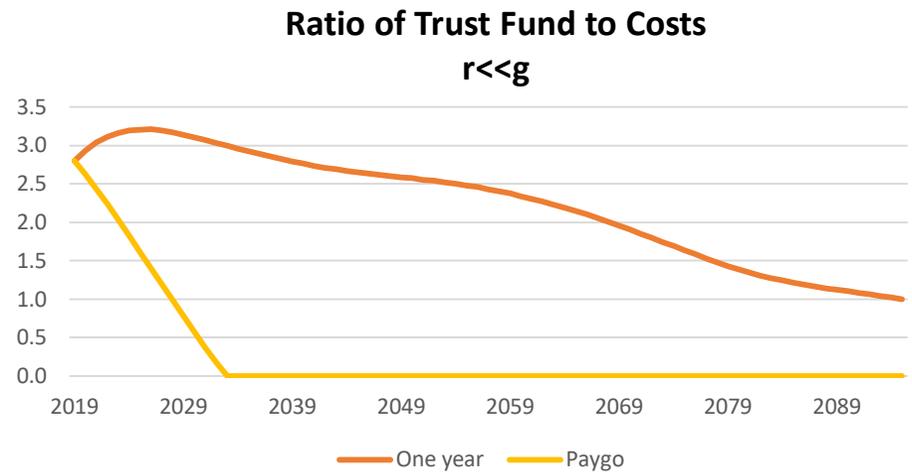
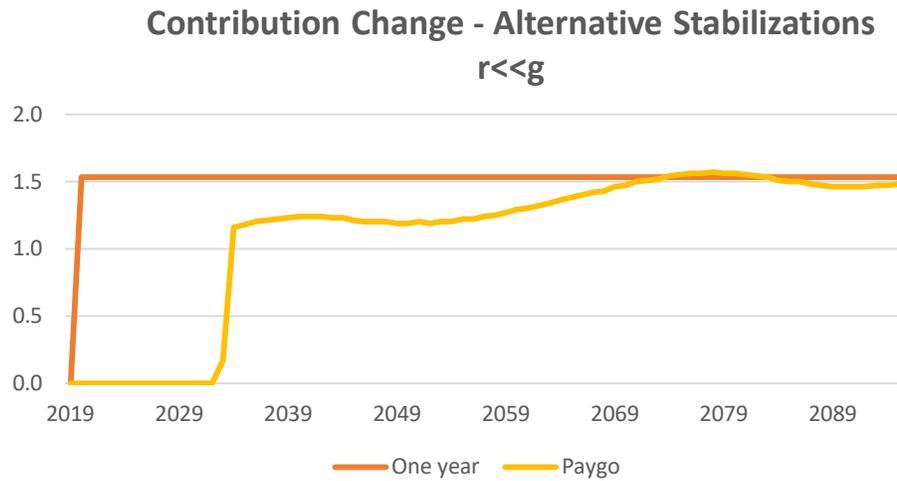
High nominal interest rate: 4.7% (SSA long run)

Low nominal interest rate: 1% (a bit higher than now)

High Interest Rates



Low Interest Rates



Thank you!

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