The Economic Club of New York

ESTABLISHED 1907

The Economic Club of New York

114th Year
584th Meeting

Peter Orszag
Chief Executive Officer of Financial Advisory
Lazard

Robert Rubin
Co-Chairman Emeritus, Council on Foreign Relations
70th United States Secretary of the Treasury

Joseph E. Stiglitz
Professor, Columbia University
Nobel Laureate in Economics

February 12, 2021

Webinar

Moderator: John C. Williams
Chairman, The Economic Club of New York
President and Chief Executive Officer
Federal Reserve Bank of New York

Introduction

Good morning and welcome. This is Barbara Van Allen, President of the Economic Club, and we will get started actually in exactly one minute. Thank you.

Chairman John C. Williams

Well, good morning and welcome to the 584th meeting of The Economic Club of New York, and this is our 114th year. I'm John Williams. I'm Chair of the Club and President and CEO of the Federal Reserve Bank of New York. The Economic Club of New York is the nation's leading nonpartisan forum 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.

A special welcome to the members of the ECNY 2021 Class of Fellows – a select group of rising next-gen business thought leaders. It appears we'll have our largest class ever this year. And a special welcome as well to graduate students from Brooklyn College, the Gabelli School of Business at Fordham University, and the NYU Stern School of Business.

Now, it's a pleasure for me to welcome our very special guests today – Peter Orszag, Bob Rubin and Joe Stiglitz. Peter is a member of the Club and is the CEO of Financial

Advisory at Lazard where he leads the firm's advisory businesses that serve companies and governments across the globe. Bob is also a very longtime Club member. He's co-chairman emeritus of the Council on Foreign Relations and, of course, former Secretary of the U.S. Treasury. Joe is a university professor at Columbia University. He's also the co-chair of the High-Level Expert Group on the Measurement of Economic Performance and Social Progress at the OECD, and the Chief Economist of the Roosevelt Institute.

A recipient of the Nobel Memorial Prize in Economic Sciences and the John Bates Clark Medal, he is a former Senior Vice President and Chief Economist of the World Bank and former Chair of the Council of Economic Advisers.

So the format today will be a conversation in which we discuss their Peterson Institute for International Economics policy brief titled, "Fiscal Resiliency in a Deeply Uncertain World." Now I'm fortunate to be able to do the honors as moderator. And as a reminder, the conversation is on the record. We do have media on the line. So the plan is we're going to start some short presentations to summarize the paper and then we'll go to the discussion. So we'll get started with Peter, who will provide a brief overview of the paper and its conclusions and move from there. So I'll turn it over to you, Peter.

Remarks by Peter R. Orszag

Okay, John, thank you very much. It's a pleasure to be with you. Let me just provide a little bit of a framing or overall picture of what were the key points in this paper and then we're looking forward to the discussion.

I think the debate over the $1.9 trillion relief package that is in the newspapers and making headlines across the country really underscores the core point of this paper. One way of viewing that debate has to do with potential output and what I would say is that estimates of potential output today, let alone for the end of 2021, are very imprecise so claims about the proposed package's effects that are unduly tied to exact estimates of output gaps or potential output are likely to be misleading.

And this moment, therefore, illustrates our major takeaway which is that we are quite cognizant of how often economic and budget projections are wrong and rather than being surprised once again in the future when reality intrudes on a confidently-made prediction, we believe that thought should be incorporated in the design of our fiscal policies in the first place. And again, I think it has direct implications for the current debate over the Biden relief package.

Another perspective on that same core point is to recognize that the era of low interest rates is perhaps teaching us the wrong lesson. It is not that rates will necessarily stay this low forever, which is how most of the fiscal debate was being framed at least up

until the past week or so. It's instead that we are very bad at predicting the future, a fact that goes well beyond how poorly we anticipated the era of persistent low rates. So we, therefore, need a new fiscal paradigm to reflect deep uncertainty rather than just a shift in the parameters that are used to evaluate fiscal policy to reflect, for example, the current era of low rates. We instead need a whole paradigm shift.

So that may all sound kind of interesting and fancy but what does it mean in practice? And we provide a few specific guideposts. First, we're very skeptical of arbitrary top-down fiscal anchors like the deficit or debt or even net interest as a share of the economy. Instead, we believe that policymakers should reserve full discretion to be able to adjust to economic situations without being constrained by arbitrary top-down anchors. But at the same time, we would have the budget respond more automatically to short-term economic conditions and to long-term drivers within each major entitlement program basically to ease the decision-making burden embodied in the discretion that we mentioned.

So the result is what we call semi-autonomous discretion. We fully acknowledge that we may not be the best marketers in the world and are open to better names, but the underlying idea is akin to assisted driving. So retain full autonomy for the driver but make the process more focused by helping to guide the car automatically in response to the environment.

So, in addition to embracing substantial additional fiscal support for the economy in the short run, we sketched five elements of what a new fiscal architecture could look like. The first is stronger automatic stabilizers. That's the part of the budget that responds automatically to the ebb and flow of the economy. The second is a new infrastructure program that offsets the growing pro-cyclicality of infrastructure spending. The third is to extend debt maturities. The fourth is to index long-term fiscal programs to their underlying drivers like life expectancy. And then finally, that residual fiscal discretion that would rest on top of these automatic features of the budget.

So first, a little bit of context about interest rates in particular, because a lot of the debate over the sort of new fiscal policy approaches, which are actually often the old fiscal policy approaches – we've come full circle – but a lot of it has to do with rates being, interest rates being lower than the projected economic growth rate. And that creates a different set of fiscal policy considerations than under a more traditional perspective where the interest rate is above the long-term growth rate.

What we highlight is not that R minus G condition, but rather how much uncertainty there is about interest rates. There is a recent CBO analysis, for example, that links lower rates to a whole variety of different factors involving potential growth, savings rates, slowing labor force growth, changes in the capital share of income. These are all things that we can have a lot of uncertainty about going forward and therefore interest

rates themselves going forward may well look different than what's happened over the past decade.

And just to illustrate how sensitive the budget is to this, to take one metric that our friends, Larry Summers and Jason Furman, have put forward, which involves net interest as a share of the economy, a 25-basis point increase per year in interest rates, that accumulates, so it starts at a 25-basis point increase and then it goes to 50 basis points and then 75 basis points in the third year, these are not major increases, certainly within the plausible range of what might happen. That kind of trajectory would shift net interest as a share of the economy by three-quarters of a percent of GDP by 2025, which is not too far out into the future, and by 2% of GDP by 2030. In other words, even that modest change in rates over time can swing metrics like net interest as a share of the economy by as much as the target itself. And that illustrates our point that we have to be careful about these top-down anchors.

And just to highlight the problems there for a moment, there are two core problems with any top-down fiscal anchor, like we should aim for a certain deficit as a share of the economy or we should aim for certain debt as a share of the economy. The first problem is that the threshold itself where this sort of no-fly zone resides depends on a whole variety of factors – investor perception, the state of financial markets – many variables that are typically beyond the purview of most fiscal models. And it also depends on

political economy considerations such as the degree of social willingness to accept higher taxes and/or lower spending to address fiscal instability. What that means, in turn, is that there is no one threshold that exists across time and across different countries that is the ultimate truth. It's going to vary across different scenarios.

And the second problem is even if we knew what that, you know, single threshold was, it's going to be very difficult to know when we would hit it because the deficit and debt forecasts are so uncertain. So, for example, the two-thirds confidence interval around CBO's five-year deficit forecast is 4% of GDP. For debt, it's 12% of GDP. It just shows that, like with the net interest threshold that I was mentioning before, it's very difficult to know with conviction, even if we knew what the right threshold was, which we don't, when we would hit it. And therefore, it's not really actionable in terms of providing guidance to policymakers. And typically what happens is you wind up with very arbitrary metrics as a result. So the famous Maastricht 3% of GDP deficit target, for example, was made up – as we mentioned in the paper – by two junior French bureaucrats who just needed a number so they picked that and then it became kind of some sort of law that needed to be obeyed.

So let me just very briefly tick through the elements of what we propose instead and then turn it over to Joe. The first is to strengthen the automatic stabilizers. This could be a big part of the debate currently so somewhere between a half and two-thirds of the

package that's being proposed by President Biden could be in the form of automatic stabilizers at least theoretically and that would presumably change the debate over both the size of the package and also any risk of inflation because the other thing about automatic stabilizers is if the economy does heat up, then they fade, and if the economy remains weak, they would remain in place. And we'd be happy to talk in more detail about that.

The second focuses on infrastructure itself. So infrastructure spending over the past couple of decades – this may not have gotten very much attention – has become pro-cyclical. That is, it varies positively with the overall economy and that's the opposite of what we would want. We typically would want more infrastructure investment to be made when the economy is weak instead of when it's strong. So we propose a new infrastructure spending that would expand during recessions and that would offset that increased pro-cyclicality that has occurred over the past several decades in that category of the economy.

The third element is to lengthen debt maturities. So in an era of low interest rates, but even not in an era of low interest rates, there's an argument for lengthening debt maturities and perhaps we'll get into more discussion on that topic, but that would be the third element of our proposed fiscal approach.

The fourth element involves indexing key programs to their underlying drivers. So as one example, an important element of Social Security's long-term fiscal balance involves the evolution of life expectancy, not only the average life expectancy but also the life expectancy for different segments of the population. And the program could be indexed to life expectancy in a variety of different ways. Peter Diamond and I had proposed something many years ago. There are different ways of incorporating the evolution of life expectancy into the program automatically but moving in that direction is what we would embrace.

And then finally, there is – beyond all of that – recognition that we're going to need discretion, that semi-autonomous discretion that I mentioned earlier. And as an example of that, Bob, Joe, and I have different views about how policymakers should act whenever we get back to full employment, whether that's in late 2022 or, you know, plus or minus from that date. And I think that illustrates another core part of the proposal here which is there is always going to be a judgment or discretionary component that should exist for fiscal policy.

And then finally, before turning it over to Joe, let me just say one of the features of writing this paper was to demonstrate that different parts of the policy spectrum can get together on important questions. I think many people were surprised that Bob and Joe would be on a paper together and agree on so much. In fact, I remember quite well an

article about a decade ago now maybe that said that I personally was caught between Bob Rubin and Joe Stiglitz and the views would never be reconciled, and I'm glad to demonstrate that at least for this paper we were able to come together. I think that is a mini-lesson perhaps for the pathway forward for policymakers in a highly polarized environment. With that, I will turn it over to Joe.

Remarks by Joseph E. Stiglitz

Okay, well, thank you very much. Let me spend most of my time talking a little bit, just like a few minutes, about the connection between what we've done and some changes in economic theory and economic perspectives more broadly. But first, I want to emphasize this is more, the paper is about more than just fiscal resiliency. It's about macro-stability and it's about programmatic resiliency like, as Peter talked about, making sure that social insurance programs are resilient in the face of these deep unknowns that we face.

So the underlying point of departure is a recognition that we are buffeted by shocks that are very hard to predict. And this contrasts with the dominant macroeconomic models of the last 25, 30 years where there was assumed to be rational expectations, well defined probability distributions that are corresponding to the frequency distributions. To put it another way, stationary stochastic processes. So that was a framework that everybody

was working in and now we've had the shock of 9/11 in 2001, the shock of 2008, the shock of Trump, and then the shock of the pandemic. And so all these shocks in a space of 20 years should make us feel less confident that the world is easily described by a set of probabilities that we can easily understand.

But while there are all these things that we can't actually forecast precisely, or even imprecisely, there are certain things that we know. So the art of policy is to bring together what we know with what we don't know. So if we look over the history, almost always we would have been better served if we would have had better automatic stabilizers. And to put it another way, we have been badly served by automatic destabilizers. Peter mentioned one automatic destabilizer – infrastructure – state and local expenditures have been an automatic destabilizer for a very long time. It undid a lot of what was done in The New Deal and it's a major problem right now. So that's an example of a policy framework where we don't have to know everything about the world to know that it's a good thing to have automatic stabilizers.

Another example of a general principle is that in the face of risk, you want to hedge. And this just highlights the point that Peter emphasized, there's just a lot of things we don't know. We don't know whether interest rates are going to remain low forever and we want to hedge.

A third point that comes out of behavioral economics is that we have cognitive limitations and it's even more important in social decision-making. So there are things that we know we will want to do. We want to maintain, you know, every time we have an economic downturn, we decide that we want to extend unemployment insurance. We shouldn't be occupying scarce decision-making time, either at the individual or social level, to do things that we know ex ante that we're almost certain going to want to do. So we want to build those in to our policy framework.

And then the final point is that no matter how much we build in – automatic stabilizers, taking out the destabilizers, hedging – there's going to be an idiosyncratic aspect of every major event – pandemic, financial crisis of 2008, 9/11. And that means we will want to have discretionary policies to respond to those idiosyncratic things and because the world won't evolve exactly in the way that we might have anticipated. And so what we've tried to do here is to put together a framework that brings together a lot of the general lessons that we know from a long history of having to deal with economic fluctuations and programmatic changes in the economic environment but at the same time allows us then to focus on the things that are new through discretion.

Chairman John C. Williams: Thanks Joe. Bob, let's turn it to you. You're muted, Bob.

Remarks by Robert Rubin

Oh, okay. It's better when the mute is off I guess. Okay. I'm going to comment very briefly on just one topic. I totally agree that in the context of today's environment we need to have something large and we need to have something quickly and so I'm totally in favor of that. But having said that, as we say in our paper, there was an issue on which we have somewhat different views. And I think the fact that we all came together the way we did, as Peter said, is a really worthwhile lesson in terms of what one can do if one sits down in a, is willing to engage with people who have different views in a reasonable way and focus on facts and analysis.

Having said that, I do think that our current fiscal trajectory presents serious questions and possibly risks for the intermediate and longer term, and those risks are five-fold. Number one, undermining business confidence because of uncertainty about future policy. Number two, diminished resilience. That hasn't been a problem so far, but if we continue to ratchet it up, our debt to GDP ratio, it seems to me at some point almost surely that will become a serious problem, not foreseen in advance, and therefore having to be dealt with in a very difficult way if we allow ourselves to remain on this trajectory.

We have a reduced fiscal and political capacity for public investment though our society

needs public investment very badly. I believe that our fiscal trajectory for the intermediate and longer term creates an increased risk of Treasury and other interest rates rising in ways that are adverse with respect to our economy. Inflation seems to me is a risk at some point. And finally, the possibility of severe market conditions, bond market conditions, and then with that all else, currency conditions and economic conditions.

These risks have not materialized for a long time but it seems to me that all of economic and financial history suggests that when market conditions, which broadly speaking is what we're talking about with respect to interest rates, and the various other factors that I've mentioned, business confidence, etc., get out of sync with fundamentals, then at some point those conditions adjust and adjust, can adjust very harshly and very rapidly.

Howard Marks, who is a member of The Economic Club of New York and I think a very thoughtful commentator on economic and financial matters, wrote a piece in 2019 in which he said the most dangerous words for investors are "this time it's different." And two of his examples of this time it is different, current examples are number one, "national debt isn't worrisome." And number two, "federal deficits can grow substantially larger without becoming problematic." Obviously, this time could be different but it seems to me that all of economic and financial history suggests the probabilities that this time is different over the intermediate and longer term are unlikely.

And we don't have to take this risk. Our task revenues as a percentage of GDP prior to the pandemic were very low by historic full employment standards. So we have a lot of room, once we get back to full employment, which is when I'm arguing we should deal with our fiscal trajectory, we have a lot of room to increase revenues, both to finance badly needed public investment and to reduce our fiscal trajectory.

I think the only other comment I would make in this respect, and I said it already but I'll say it again, we are increasing our debt to GDP ratio very substantially when we need to do it, and I think we should be doing it now. But at the same time, when we do that when conditions are difficult and we don't repair that when we have good economic conditions, then we have, we are ratcheting it up. And as we continue to ratchet it up from already the highest levels, debt to GDP ratios since the end of World War II except in the period that we were phasing down right from the Second World War, and it seems to me that's a very dangerous place for us to be.

So my final comment would be this. I think that even as we do what we're doing now and we absolutely imperatively must do now, I think that what policymakers should be doing is thinking about what should our fiscal strategy be for the intermediate and longer term? And how do we feel, once we've made that decision as to what our trajectory should be or what our fiscal strategy should be, how do we implement that? And with that, Peter, or I guess, John, I'll turn it back over to you.

QUESTION AND ANSWER PERIOD

CHAIRMAN JOHN C. WILLIAMS: Well, thanks to all three of you. That was a great introduction to a bunch of themes that we'll come back to now. And so I'm just going to start with questions. I think I'll probably throw them to individuals, but obviously all three of you can respond.

The first thing, you've already talked about, it's what's striking is that, you know, each of you has decades of experience in the world of public policy and thinking about these issues and firsthand experience of working on these issues at very senior levels. So my question to you is what really was the imperative to bring you together on this paper and the imperative for the need for these specific proposals that you outline in the paper? And in particular, what is it that's been, what's changed in the world over the past few decades that's influenced your thinking of these issues? Joe talked about that a bit in his comments, kind of the changes in the world, but I was curious. So maybe I'll throw it to Peter first if you have some thoughts on this and then the other panelists can chime in.

PETER R. ORSZAG: Sure. So I think the immediate impetus for this was really the re-engagement of the fiscal debate, that it surrounds the dramatic decline in interest rates that we have experienced over the past decade. And so over the past several months

there have been a variety of interventions or papers that have been put forward – Olivier Blanchard, I already mentioned Larry Summers and Jason Furman, and others. And so I found it interesting that in separate discussions with Bob and Joe, they both shared the concern that we were projecting forward that era of low rates with a very high degree of conviction in almost all of those discussions and neither one of them felt comfortable with that. So this sort of slightly odd couple nature of that led to the thought that we could do something together I'd say. And then we spent a pretty intense time over winter break and so it could, the paper could have also been subtitled, "How We Spent our Winter Vacation."

JOSEPH E. STIGLITZ: So let me add one thing to that, which is, you know, Bob and I have spent much of our life dealing with uncertainty in different ways – mine as an academic and Bob actually dealing with it in the real world. And it's so clear that the last few years have presented us with this deep uncertainty, a highly uncertain world. And we have to think about policy frameworks for dealing with that uncertain world and that's really what we were trying to do here.

ROBERT RUBIN: I have nothing to add, John. I think they've said it very well.

CHAIRMAN JOHN C. WILLIAMS: Thanks. And, you know, I mean, I think this issue of the deep uncertainty and the way, Joe, you talked about it, got into the lingo of

economists, but I think it's very much a reality. And we obviously talk about this in the world of central banking as well for the same reasons you did. You know, linear Gaussian models – I'm going to stay in that framework – don't really help you think about things like the examples you gave and obviously financial crises and pandemics and the other structural change that we talked about.

So, you know, one thing though that, you know, I was thinking about coming from my world of monetary policy and central banking is we like anchors. We like to have well-anchored expectations. We like to have that inflation target anchor. And in your paper, you argue against top-down anchors. You talked about it, Peter, I think some in the introduction about, you know, the ratio of debt to GDP, that these are flawed ways of thinking about that. But if those aren't the right ways to think about what sustainable fiscal policy, what good fiscal policy, long-run fiscal policy is, what should replace those top-down approaches as we think about and debate what good fiscal, a long-run fiscal policy is? I'll let anyone jump on that question.

PETER R. ORSZAG: Joe, do you want to take the first crack at that?

JOSEPH E. STIGLITZ: Okay, well, in a word, take the issue of debt, which Bob has talked about and everybody worries about, well, there is something called deck sustainability analysis. You know maybe what I'm arguing for is a full employment act

for economists. But what we're saying is you can't use just a simple rule. You have to incorporate a more subtle analysis where you look at various trajectories, correlations, and you ask what are the various scenarios and you keep in mind the issue is what are instruments that you can use in the future if things turn out worse than you thought they were going to be.

So, for instance, right now there's been a lot of discussion about are we spending too much and there might be inflation. But we know that there are instruments available if that turns out to be the case. We can raise interest rates and, you know, it would be a good thing if we raised interest rates to put us in a more normal situation. It is very distortive to have this almost-zero interest rate environment for a very long time. A lot of people are worried about how that distorts markets.

And Bob emphasized we have an unusually low tax to GDP ratio and we've wound up with a regressive tax system. It would be a good thing if we changed that to make it a more normal tax structure, progressive, and a more normal percentage of GDP corresponding to the needs that we have for infrastructure, R&D, and so forth.

ROBERT RUBIN: I guess I would answer, I'd agree with Joe but just add a little, one thing to that, John. I think arbitrary anchors just haven't worked and you can see it with Maastricht and so forth. So I think you can't get away from having to make judgments

and what we've tried to do is just limit the area in which you have to make judgments by the automaticity and then the indexing. But I think ultimately you've got to look at judgments and judgments are highly imperfect. Your projections are highly imperfect. They're highly uncertain as we've emphasized throughout our paper. But, on the other hand, I think they're better than arbitrary anchors.

PETER R. ORSZAG: And, John, if I could just quickly add, I mean this part of the debate, I think, has a lot of parallel in actually a different paper that Olivier Blanchard had co-authored that speaks about the flaws in fiscal anchors so it's very much aligned with us on that and then embraces what they call fiscal standards instead. So this is more akin to the system in New Zealand where it's not we should hit X percent of GDP as a deficit but rather we should have a sustainable fiscal policy. Now, what does sustainable mean? Well, that's what the debate then becomes instead of the false precision of a particular number that's attached to it. So it's perhaps more satisfying and kind of easier to grasp if we say we have to hit, you know, 3% of GDP as a deficit and it's kind of simple, but to Bob's point, because it's been arbitrary – whatever number has been picked, it's been too arbitrary – it never works. And so I think it's a little less comfortable to be in a fiscal standard world rather than fiscal anchor world, but it's a better place to be.

CHAIRMAN JOHN C. WILLIAMS: One of the things in the paper and I heard Joe and I

think every one of you say is that we're just really not good at making long-run forecasts of the economy. And I think personally it's because a lot of those things are hard to forecast that underlie that – demographics, productivity, you know, other global factors. And so that's something you've emphasized. You give some great, you know, evidence on that. And all of us who have worked in public policymaking in the last several decades have seen how these structural changes have become in ways that were, you know, weren't well predicted in advance.

But, you know, again I kind of go back to you're taking things away that we tend to use as tools. So, Joe, you used the example which I agree with that, is do more scenario analysis. So can you talk, and say I'm saying here's our point forecast, everything hangs off that and that's what we have to base everything on but do more of the scenario analysis. Can you talk about how that can help us think about where the risks are and how we plan, or more generally what replaces these long-run forecasts that have been shown to be unreliable?

PETER R. ORSZAG: And, in fact, I mean I think we can talk about that in the context, the immediate context of the relief package debate because I go back to, we don't even need to do a long-run forecast. It's a similar thing, though. The concept of potential output is I got a lot of imprecision around it, where exactly that threshold is, what is potential output? And so a debate in which we say we're 2.7% above potential output if

this full package is passed and therefore we will have X and Y happen is probably a lot less insightful than something that talks about the distribution of risk that come from either undershooting on the economy or perhaps overheating in certain sectors.

And so what we're living through literally this week is, I think, a great illustration of this point. We would be a lot better off if people were talking about the risk of undershooting and the risk of overshooting and not kind of tying it off of the false precision of we know we're going to be 2.X% above a concept of potential output. Again, it requires more judgment and discretion because you're taking a lot more complexity and you're trying to not boil it down to an overly simplistic conclusion. But it is likely to lead to better decision-making.

JOSEPH E. STIGLITZ: Let me just emphasize a couple of the uncertainties that we don't know. We don't know, for instance, how quickly the pandemic will be controlled all over the world, whether there's going to be mutations. We don't know our exports, because our exports depend on how well it's controlled in other countries. So even if we feel good about what we're doing at home, there's lots of uncertainty about what other countries are going to do. So there are all these uncertainties about how the economy is going to evolve. And that's why I put a lot of emphasis on thinking about whether we have tools at hand, if it turns out that things turn out to be better than we thought, can we dampen it down? Can we shut off?

I mean, for instance, one of the important things is the provisions in the bill that are, unemployment insurance, if we get to full employment we won't be spending that money. Now we think we ought to have even more automatic stabilizers so that if it turns out that the economy recovers, we don't have to get together again, it just automatically shuts down. But, on the other hand, if it turns out that we're too optimistic, then having a little bit more gas in the engine would actually be a good thing.

ROBERT RUBIN: I'll just add one comment, John, referring to Joe's scenario analysis. As long as I've been involved in doing this, which is a long time now, that's what I've always tried to do, to lay out scenarios and then put probabilities on them. And as Peter says, saying that growth is going to be 2.7%, one thing you know about that number is it's wrong. But if you think in terms of probabilities and probably distributions, then you make judgments, and judgments are highly imperfect but you can correct your judgments and then you try to be as well-informed as possible. I don't think there's an alternative to that that makes any sense.

CHAIRMAN JOHN C. WILLIAMS: I mean, you know, there's such a strong parallel in this whole discussion we're having in the monetary policy world too, that I live in every day, about risk management and about, you know, where are the distribution of the risks and what are the tools you have to deal with different things in the future. This is also one of those rules versus discretion debates that, of course, has gone on for

decades. And the reality is that you need to have that ability to manage the uncertainties and risks when you, you know, practical policymaking.

But, you know, let me stay on this theme of getting this mix. Joe, you had a great way of saying the art of policymaking is putting together what we don't know and what we do know effectively. So, you know, when you think about building stronger, you know, a system, well, let me just start with the proposal you had specifically around Social Security and Medicare and that was design it to be sustainable and incorporate structural changes or demographic changes going on in our labor force and other factors. So build those into the system, as I understood it, but please correct me if I didn't get it right but build that into the system so you're not having to fix it along the way.

But how do you build that in given all this kind of uncertainty and structural change that is kind of hard to know in advance. How do you get that right mix of what you do know and what you don't know when you do the design of that? Or, of course, the same question would apply to how to build automatic stabilizers that are kind of robust to a wide range of circumstances and you don't need to end up using discretion a lot?

JOSEPH E. STIGLITZ: I would say automatic stabilizers at a macroeconomic level, we actually, I think, understand better. We have a lot of sensitivity about what are even the

best automatic stabilizers, the bang for the buck. Unemployment insurance is a good automatic stabilizer because it deals with the worst social consequences of an economic downturn. At the same time, it stimulates the economy with the right dosage of the medicine. So that's one.

The thing that we talked about in the paper of trying to design infrastructure to be more of an automatic stabilizer requires a little bit more, you might say creativity and innovation, but we think it can be done. I think matching grants for states and localities to make up for revenue shortfalls or what we call constant tax effort revenue shortfalls is another area where it's easy to do and that is an area where we know things have gone very badly for a very long time.

The programmatic ones are a little bit more difficult and Peter has worked more on that, but there are some aspects of that we know. We know that there are long-term trends in life expectancy. And so if we want to have a viable social insurance program, we're going to have to finance it. And there are many different variables like retirement age, the benefits, the taxes, that you can adjust. And so part of the idea that we put forward here, it's difficult politically, is that when you design a program you should talk about how you're going to make the adjustments ex ante. And we might disagree and that would be part of the political discourse at the time the program is adopted, which of the variables you would want and obviously there will be some compromise and there will

be some differences. But we ought to think about, we want to make it sustainable. That should be our commitment. It's really important to have social insurance. That's really a national commitment. And so we want to make sure that we can continue that program in one way or another.

PETER R. ORSZAG: Let me comment specifically on Social Security just as one example. So, you know, there are two concepts that often kind of get conflated and are easy to mix together. One is that a purpose of Social Security is to make sure that as an individual I don't outlive my savings, that there's a payment per month or per year that lasts as long as I'm alive and that is protected against inflation in case it turns out I live longer than was expected and that can be offset or there's sort of risk sharing with those who unfortunately passed away earlier than expected and so they don't get their benefits for as long as even the kind of average.

That kind of pooling or risk sharing is a core feature of the whole purpose of Social Security. That is a different issue, even though it's obviously related to what happens when everyone lives longer and the average itself goes up over time. That's what we're talking about here which is that latter piece, the program needs to finance or pay for somehow. It can't just be risk sharing across individuals when life expectancy for everyone goes up. And to Joe's point, we think it makes sense for that to be sort of built in automatically into the program. It also helps to simplify in some way the residual

decisions that policymakers need to make because there are underlying adjustments that are sort of going on under the hood – as it were – and if there still is an overall fiscal problem at the end of that or, you know, in real time, you can adjust but some of the underbrush has already been cleared away for you.

CHAIRMAN JOHN C. WILLIAMS: Peter, since you've, you know, been in this seat, in a role very close to how these things are scored and how the rules work – both in Congress and kind of, you know, like the scoring of things – do you think that some of that gets in the way of good design of these kinds of, you know, sustainable policies? Or does the way we do things, you know, make it harder to accomplish this, or how do you think about that?

PETER R. ORSZAG: Yes and no. So, sorry for the two-handed answer, but one of the, I think the major impediments to getting automatic stabilizers built into the budget is that the Congressional Budget Office and other scorers count or would say that there is some cost to, you know, to providing that. In other words, that if you're going to say this program will kick in if the unemployment rate is high, then we've got to figure out what the probability is that the unemployment rate is high and you have to basically pay for the expected value of that scenario.

What I would say is that's worth the cost. So the yes part is yes, the scoring is seen as

an impediment. I don't think it really should be because there is a lot of value to getting this right and so we should be willing to overcome that score and do it anyway. And I would just come back to saying if all of the $1.9 trillion that the Biden team is proposing were in the form of automatic stabilizers, it's really hard to see the argument against that package because the fear that the economy would overheat is almost obviated or attenuated by the fact that if it started to, a lot of that relief would come off and so the inflationary pressure would be, any ostensible inflationary pressure would be automatically and quickly reduced.

And then vice-versa, if we need more than the $1.9, who knows how bad the future pandemic – to Joe's point earlier – might turn out to be, well, then you've already got it in place. And so there is a difficulty of doing this. It's always tempting to kind of say we'll do the automatic stabilizers next time around. And that's what we typically always do. The scoring probably does get in the way a little bit, but we should think of it as insurance and insurance costs something but it's usually – well, not unusually – it's often worthwhile.

CHAIRMAN JOHN C. WILLIAMS: You know, I had planned more questions to dig deep into the automatic stabilizers debate and how to think about that, but I think there are members who are going to be really interested in the final topic that I wanted to bring up and Bob already mentioned it in his opening remarks and that's government debt.

So let's turn to that. You talk in your paper about extending the maturity of U.S. federal debt. And basically, you know, the argument is, well, I won't...I'll let you make the argument, but I guess my question is I feel like there's some tension in your paper and in what you've said today is that we don't know the future. It's hard to predict the future. But we really should lock in rates now. And so I'm kind of, I want to understand, and I think this is a question for each of you because I think you may have different views on this, but to understand the logic of it. If I can't predict the future, why is it an imperative to lock in these long rates today by extending the debt? So, Bob, I'll start with you if you don't mind. You're back on mute, I think.

ROBERT RUBIN: Yes, it's better if I get off mute, isn't it? Okay, good. I think I'd frame the question a little differently than you did, John. No, we can't know what future rates are going to be and we can't predict. But as you said before and I'm sure you do this at the FOMC, you can deal in probabilities and that's all you can do, and scenarios. And I'll give you one person's view at least. I think when you look at rates where they are today, I would guess that probabilistically there's an asymmetry going forward.

And the probability of rates, take the 10-year for example, the 10-year going down by 300 basis points or 200 basis points or whatever number you want to use is probably considerably lower than the probability of it going up – whatever those various probabilities may be, but the relative probabilities. And so given the asymmetry, I think

that – if it were me at least – if I were Treasury today, I would be extending the maturities.

Secondly, by extending the maturities, you take out instability. You reduce instability. It's a point Joe likes to make and I think he's right. I think that you should be willing to pay something to reduce instability. So for both reasons, I would extend the maturities.

CHAIRMAN JOHN C. WILLIAMS: I'm going to throw it to Joe because this is something you both agree on so let's hear Joe's view.

JOSEPH E. STIGLITZ: The point, the second point is what I want to mention. Even if I do think that the interest rates were unusually low, I mean I do agree that they are, they're not going to go very negative, so if you looked at it just in those terms, it's more likely that they're going to go up than down. But even if you assumed that what we sometimes call the expectation hypothesis is correct and the long rate is equal to the product of the expected short rates and there's no yield curve, so even in that case, what we know is that it is difficult for the government to make a lot of adjustments.

So think about what would happen if everything was short-term bonds and then at some time, three, four, five-years from now, interest rates went up a lot. That would mean that the government would then have to pay a lot of interest. And that would mean that

either taxes would be increased. It would have to borrow more, a whole set of things that would have to adjust. And if there are those costs associated with those adjustments, one way of mitigating that is to hedge.

And by having long-term bonds, you are reducing the impact on the budget three, four, five years from now, if it turns out that the interest rates go up, so just a hedging point. And it says if there are costs of adjustment, you're willing to pay something for that hedge. And then the question is the judgment about how much are you paying for that? And that has to do with the yield curves and where you think interest rates are going to go. And there we could have a discussion, there's going to be judgment.

CHAIRMAN JOHN C. WILLIAMS: Peter...

PETER R. ORSZAG: I think they've summarized it.

CHAIRMAN JOHN C. WILLIAMS: Okay, so let's turn to the last topic.

ROBERT RUBIN: John, I would observe, you can inform that judgment by telling us what you think is going to happen to interest rates over the next year or two.

CHAIRMAN JOHN C. WILLIAMS: And instead of that, I'm going to go to the last

question. (Laughter) So, Bob, I think you talked about this at the beginning. Maybe everybody did. There's an active debate out there and commentary that with very low rates – this is the commentary – with very low interest rates for the foreseeable future, worrying about government debt is simply misplaced. So the question is, is there a free lunch? Are there limits to how much governments can borrow in your view? And how would you even know what those limits are and whether you've reached them? So I'm just going to go across my screen which happens to be Bob first, then Peter and then Joe for your final comments. We've only got five minutes left for the whole session so just quick go around on that.

ROBERT RUBIN: Look, I think it would be nice if it were a free lunch. That would be a nice way to live, John. But if you look at all of economic and financial history, it suggests that there are no free lunches and sooner or later you pay the piper. And since I think we could do that, we could put ourselves in a very different place once you get past the current moment. We could put ourselves in a very different place relatively easily because we have such a low relationship between our revenues and our GDP. I think it's something we imperatively should do. In any event, I think that policymakers should have an explicit strategy about what they're going to do about our fiscal position. Anyhow, my view is they should both, they should be looking toward improving our fiscal position, our fiscal resources, both to fund public investment and to correct our trajectory rather than betting on a free lunch.

PETER R. ORSZAG: I would say two things. First, right now is not the moment to be overly concerned about this particular topic. We may, as we recover from the pandemic, need to turn back to it. But right now in terms of the immediate debate, the imperative is to get the economy back towards full employment. The second point is even after that point, I personally favor something, and this is actually embodied in our proposal too, something that has an underlying tendency towards zero, towards fiscal balance basically. So many of those adjustments that we were talking about earlier would have that feature. They're gradual. They can be reversed in the future if necessary. But what you're doing is foaming the runway in case you wind up with a problem in the future, it makes it easier to address rather than just waiting for a moment where you might not want to arrive. So, (a) don't worry about it right now, (b) when we do need to worry about it, the more that we can do that's gradual, long term, tilts towards zero, but could be undone. I don't worry about Congress being willing to undo fiscal restraint in the future if it is unwarranted.

JOSEPH E. STIGLITZ: Basically I agree with both Bob and Peter. Let me emphasize two things. First, that we have now a significant insufficiency, excess capacity, insufficiency of both demand and a distortion in supply because of the pandemic. So it's not a conventional economic downturn, but there are many elements of a conventional downturn in the present situation.

The second thing I want to emphasize is that the pandemic has exposed the inequalities

in our society. It's not been an equal opportunity virus, and we're having a K-shaped recovery. We know from the past that the only times that we've really had inclusive growth on gender, race, reducing wage inequalities, is when the economy is slightly heated. And so when I look at the benefit of having a tight economy versus the other side, a little bit more inflation, I weigh very strongly towards the view that we ought to take the risk of having a slightly tight economy. And that's particularly because, as I said before, we have tools at our disposal if it turns out that they really are too tight. We can raise taxes. We can raise interest rates. And that would actually improve the structure of our economy, the performance of our financial markets.

So right now, we almost do have a free lunch. That is to say, spending now does create at almost zero interest rate, a higher GDP, higher welfare, but the central point of our paper is that you can't ignore these risks. You have to be prepared for those risks. You have to be thinking about those risks. We're not ignoring them. And you have to be ready to act. But you have to look at the balance of the risk of doing too little versus doing too much and I'm 100% with what President Biden is doing and saying at this juncture, the $1.9 billion is what we need, or even better, they'd be putting even more automatic stabilizers into that that might give us more spending if it turns out that the pandemic is rougher than we think.

CHAIRMAN JOHN C. WILLIAMS: So we could continue this discussion for hours and

there's so much to talk about, but we are now out of time. So I just want to thank Peter, Bob and Joe. The paper was really interesting. It's really interesting how the three of you have come together, all the theory and the practitioner and experience kind of insights have come together on this. And I thank you for joining us and the members of The Economic Club of New York today for this great discussion.

So my last job for this session is just to note that we have more great speakers lined up as always. And we encourage you to attend our events and invite guests as well. So just a few that I'll mention. Coming up in the next few weeks, we have Marc Tessier-Lavigne, the President of Stanford University coming on February 17. We've got, on February 18, we're going to have the 2020 Racial Equity Report, a member event on that. And on March 2, we have Mary Daly, the President and CEO of the San Francisco Fed. And then in March, we have Jane Fraser at Citi, and GM CEO Mary Barra joining us for the March 11 Women in Business Conference. And then later in March and back to the Fed, we've got Raphael Bostic, the President and CEO of the Atlanta Fed coming to speak to the Club. And we've got a lot more events, of course, lined up.

And finally, I'd like to just take a moment to recognize the 324 members of the Centennial Society who have joined us today as their support for the Club continues to provide, enable us to provide our wonderful diverse programming both now and in the future. So thank you again, please stay healthy and safe.