NOT OK, BOOMER! A MANIFESTO FOR A GENERATIONAL REVOLUTION

Bottom Line:
1 – Generational inequalities have soared and lockdowns have sacrificed the young and poor to save the old and rich
2 – Due to the cost of healthcare, urban housing, and education, the young experience much more inflation than the old
3 – In 1982, a minimum wage worker needed to work four days to buy one share of the S&P 500, versus two months today
4 – The Covid-19 crisis presents two choices: the boomer ice age, or a generational new deal, which will prevail over time
5 – The generational new deal requires lower asset prices, some creative destruction, inflation, and fiscal spending

The two greatest European masters depicted the myth of *Saturn Devouring his Son* in the twilight of their lives. Rubens focused the painting on the screaming face of the devoured infant, a horrifying but logical climax. As usual, Goya is more complex and draws our attention to the terror in the eyes of the murderous patriarch, letting us imagine the invisible horror which Saturn contemplates: is it his own guilt for his crime? Or the realization that he, too, will be overcome by his son (Jupiter), just as he overthrew his own father (Uranus)?

The latter explanation would capture the essence of the myth of Saturn (the God's name in Greek is *Cronos*, the root for "time" as in *chronological*). **When a waning generation realizes its decay, it feels an urge to stop the passage of time by consuming its own children**. These attempts are ultimately vain, as every generation eventually arises from the ashes of its elder.

This report will argue that **the Covid-19 crisis is the climax in the generational conflict between Boomers and Millennials / Gen-Z-ers**. Faced with the suddenly vivid realization of their own mortality, ageing boomers have asked that the young sacrifice themselves to preserve the last years of the old. Instead of the obvious solution of leaving the economy open and quarantining the old in their homes, Boomer-dominated political systems have inflicted tremendous economic damage by locking everyone up – except for the precarious gig workers who must still toil to feed the rest of us.

Alas, young unemployed workers no longer contribute in the social security Ponzi scheme. The West's catastrophic handling of the Coid-19 crisis will leave mountains of debt which cannot be repaid and will have to be monetized by inflation, the most disastrous outcome for the rentier generation. The Magical Money Tree of central banks' asset purchases, which boomers have desperately embraced to protect the value of their portfolios from their economic blunders, will be conjured again. But this time, the magical powers of money creation will be directed towards promoting growth, jobs, and social programs, rather than endlessly inflating asset prices away from economic realities.


Saturn Devouring his Son, Rubens (1636) and Goya (1823)

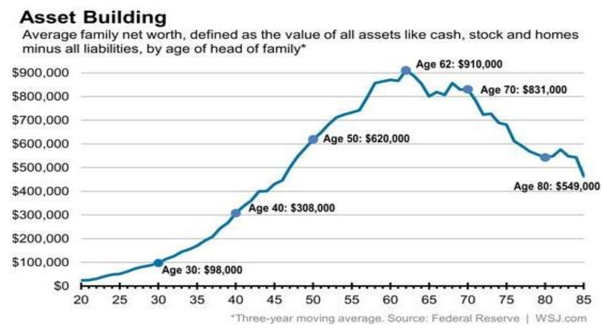
The Covid-19 crisis highlights the generational crossroad faced by Western societies: one path leads to an economic ice age of stagnant wages, zombie companies, soaring debt and addiction to monetary opioids. The other would bring a generational new deal by boosting inflation, infrastructure spending, and new home construction. A greater tolerance for the intrinsic risks of economic life would resurrect creative destruction. Economic growth, interest rates and, eventually, birth rates, would rise from their current abyss.

This new generational pact may seem distant today: yet, **history suggest that generations eventually find a way of working together, instead of consuming each other**. The nightmares which terrorized Rubens and Goya in the twilight of their lives will dissipate in the bright light of dawn.

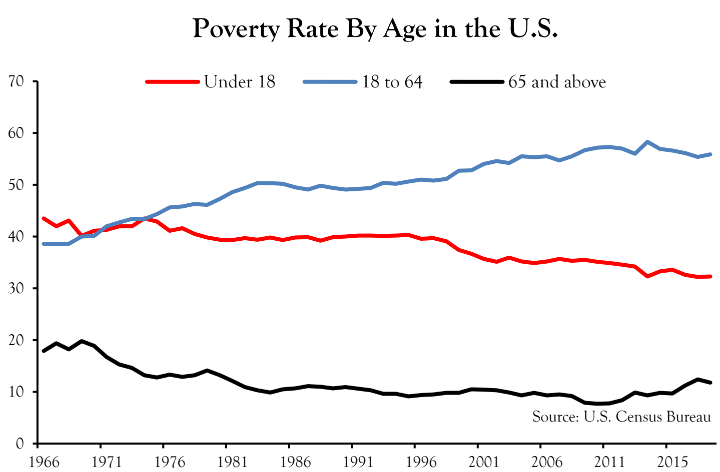
A Generational Problem Masquerading as an Inequality Problem

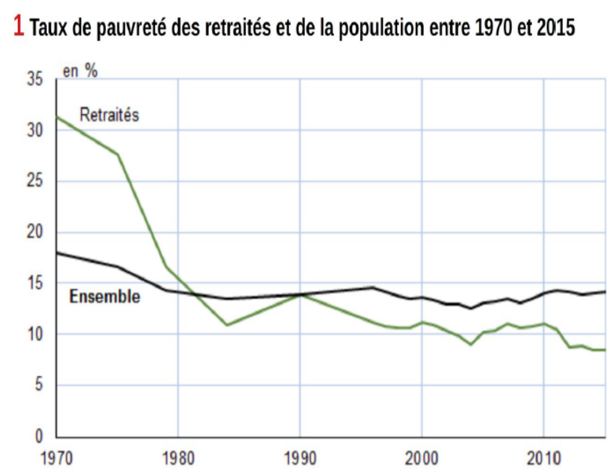
T. Piketty's unlikely best-seller, "Capital in the 21st Century", saved Marxist-leaning French economists from the terminal decline of European social democracy by creating the rapidly-expanding field of inequality studies in U.S. universities. My grocery runs at Berkeley Bowl are fraught with a far greater risk than Covid-19: unsolicited conversations about the rise Gini coefficients in OECD countries. Even trips to the Davos World Economic Forum are no longer safe from long lectures on the Cost of Inequality – a problem that IMF economists and billionaires believe they are well-suited to solve.

Economists have sliced and diced the income and wealth to show that the rise in inequality has disproportionately affected women, minorities, and other disenfranchised groups. While these assertions are certainly true, the biggest inequality is conspicuously absent from the current debate: **age is by far the single largest determinant of wealth and income**. According to the Federal Reserve, households in their 60s are about ten times wealthier than those in their 30s. The average salary for 70-year old is $83,501 a year, almost twice as much as the $48,241 salary of 30-year old workers.



This chart does not simply capture the truism that it takes time to build wealth: relatively speaking, retirees and older workers have captured a bigger share of the economic pie in all developed countries in the past 60 years. The expansion of social security programs after World War 2 dramatically reduced poverty among old workers. Conversely, relative poverty among young generations rose as a result of de-industrialization, labor market deregulation, mass unemployment, and stagnant real wages after 1975.





Sources : Insee-DGI, enquêtes Revenus fiscaux, enquêtes Revenus fiscaux et sociaux rétropolées ; Insee-DGFiP-Cnaf-Cnav-CCMSA, enquêtes Revenus fiscaux et sociaux.

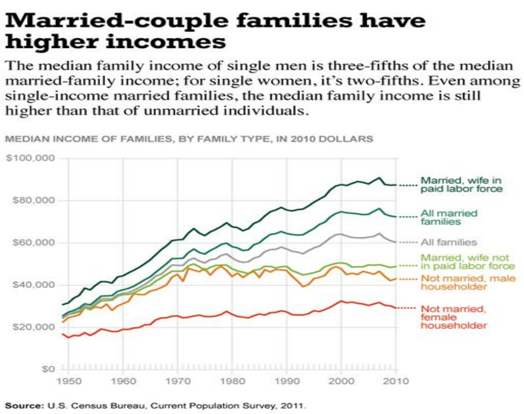
In this analysis, I have followed the left-wing consensus that economic deregulation, globalization and the cuts in social spending brought by the Thatcher / Reagan revolution have caused the surge of inequalities of the past 40 years.

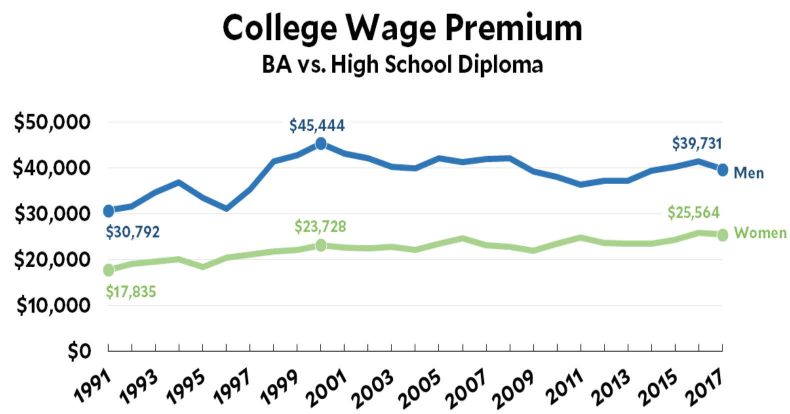
I want to briefly address the response of right-wing economists, which focused on personal decisions, such as the role of higher education and assortative mating, in the rise of wealth and income inequality. These alternative hypotheses are interesting but ultimately irrelevant to my point because the generational divide runs across public and personal decisions alike.

The decline of "wealth-creating" marriages among Millennials and Gen-Z-ers is at least partly due to unaffordable housing, which is a result of low rates, costly subsidies to homeowners and NIMBY restrictions to new construction. Precarious workers who cannot afford rent are unlikely to start the stable, home-owning, church-going households of the 1950s.

Similarly, education has had a different impact on various generations. The college wage premium peaked in the 2000s, while the real cost of higher education has kept increasing. A college degree was indeed an effective way to climb the social ladder in the 70s and 80s. **For Gen Z-ers and Millennials, tertiary education has reinforced pre-existing inequalities, rather than flattening them**.

Alternative Drivers of Inequalities



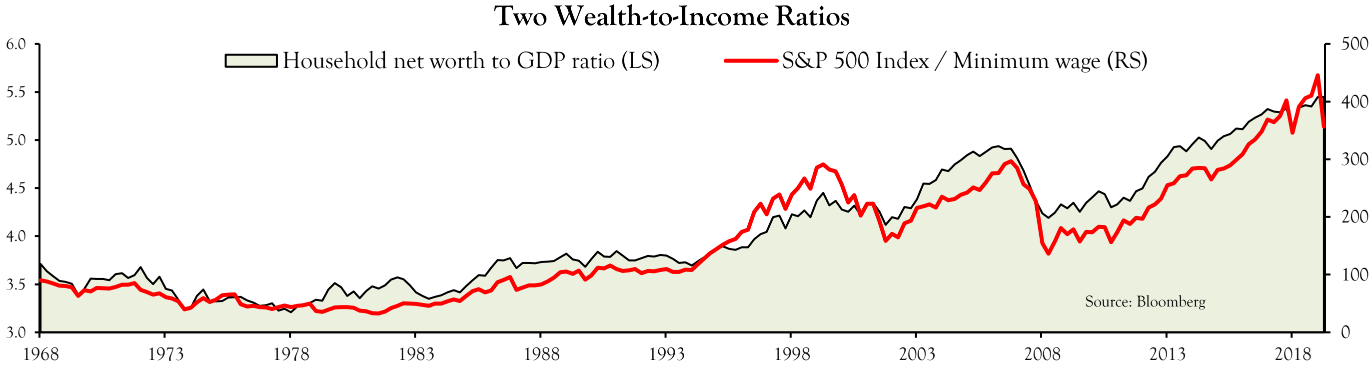


The respective roles of public and private choices on inequalities is a fascinating ideological debate, but **their effects pale in comparison with that of falling interest rates and rising asset prices**. Broadly speaking, older generations own financial capital, while younger generations' only source of wealth is their human capital, which they hope to eventually convert into financial wealth over time.

Thus, the ratio of household wealth to income reflects the relative position of various generations: a high ratio means that the old can buy a lot of labor with their assets. This ratio has risen to 5.3 from 3.2 in 1978, which implies that younger generations must work about twice as hard as boomers did in the 70s to acquire the same share of wealth. The same idea can be summarized by a simple statistics. In 1982, the federal minimum wage was $3.35 per hour and the price S&P 500 index was 109: **the lowest-paid worker needed to work for four days to buy one share of the S&P 500 index. Today, the same worker must work for about two months to buy one share in the index**.

As I argued in "a Crazy but Logical Call for Stagflation", low rates, deflation in the economy, and asset price inflation have been the biggest drivers of the generational divide. Hence, we will now turn to inflation dynamics for a possible solution to the generational problem of Western economies.

Two Wealth-to-Income Ratios



A Generational Inflation Problem Hidden by the Consumer Price Index

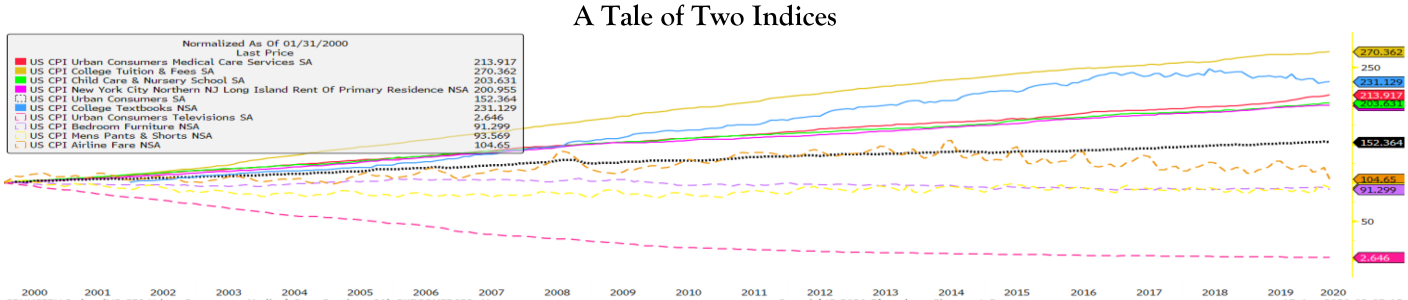
The consumer price index suffers from the same issue as someone whose head is stuck in an oven while his feet are in a bucket of ice, so that his average body temperature is about 37 ˚C.

The "great moderation" of inflation in the past two decades has been the result of two offsetting forces. On the one hand, the cost of medical insurance premia, college tuitions, rents in major urban areas, and childcare has exploded. On the other hand, the cost of most of the things which can be bought at Walmart (and are generally manufactured overseas) has collapsed.

This has led to two very different experiences for inflation: **retired boomers, who generally own their homes, live in the small towns and suburbs, shop at superstores, and can get their medical expenses paid by Medicare have experienced deflation**. As shown in the chart below, the cost of things that boomers like, such as men's shorts, televisions, Tuscany furniture, and packaged tours to Europe has fallen.

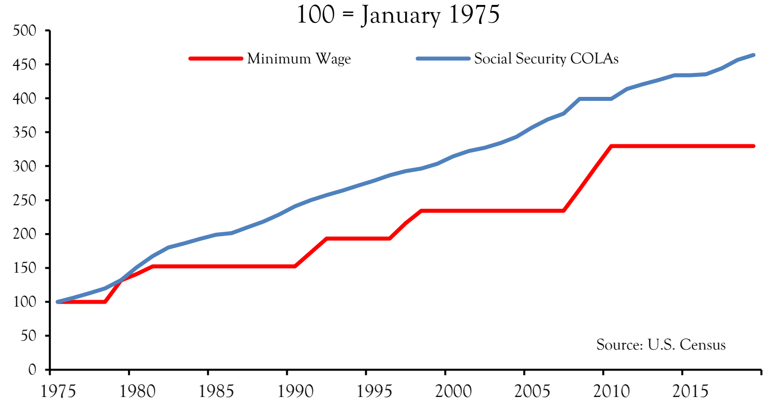
Conversely, **new jobs openings for younger generations have been almost exclusively created in major urban areas where costs have exploded**. High rents, unaffordable housing prices, double-digit annual increases in insurance premia, overpriced daycares and private schools have prevented even the most successful young workers to start families: the median age of U.S. homebuyers has risen to 33 from 29 in 1981, and San Franciscans have more dogs than babies. If "Friends" was shot today, the roommates would likely be a big-law attorney, a hedge fund analyst, and a computer science PhD, rather than a waitress (Rachel), an aspiring singer gigging as a masseuse (Phoebe), and a struggling actor (Joey). They would also most likely be in their late 30s, rather than their early 20s. Also, the rent on the shared apartment would be about 50 times the $200 a month that Monica supposedly paid[1], and it would be deep in Queens rather than in the West Village.

A Tale of Two Indices



These differences in actual inflation between age groups matter because they also affect income. Social Security Cost of Living Adjustments (COLA) are indexed Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W)**. In other words, the more life becomes unaffordable for young urban workers, the bigger the checks to retirees in the suburbs and in the countryside**. As a result, Social Security payments have increased by a comfortable 3.6% annually since 1975, while the federal minimum wage has risen by just 2.7% compounding to a cumulative gap of 40%. It has been the best of times for the old rich idle, and the worst for the young working poor.

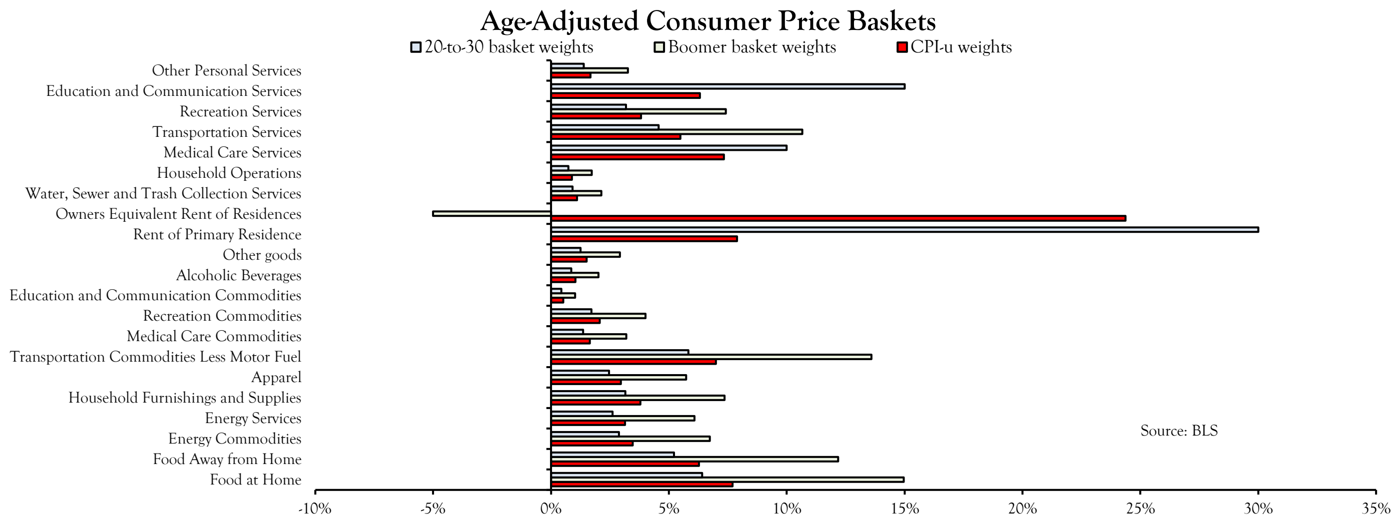
Federal Minimum Wage versus Social Security COLAs
100 = January 1975



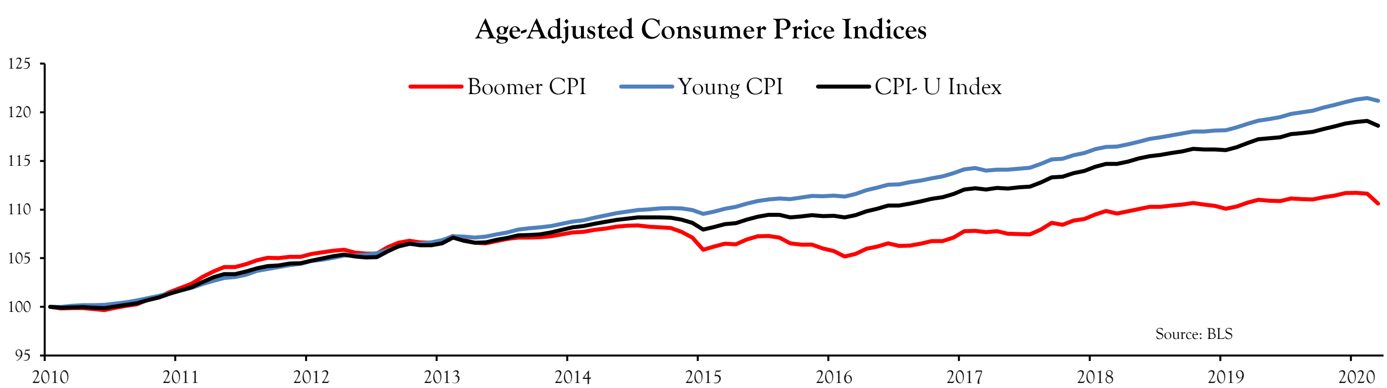
[1] The $200 rent on Monica's 139 square meters Greenwich Village apartment was already major plot flaw even when the first episode aired in 1994.

Fairness would require that statisticians disclose **two consumer price indices**, which could be achieved simply by tilting the weights on the existing basket of goods and services used in the consumer price index for all consumers. In the chart below, I have adjusted the weights as follow:

- Rent accounts for 30% of young worker's basket, which is typical in major urban areas. Boomers and the 65+ group own their homes and thus do not pay rent.
- The weight on "owners' equivalent rent of residence" is zero for young workers, who do not own their homes. It is *negative* 5% in the boomer index to reflect that rising home prices benefit homeowners, who can earn income by renting extra bedroom on Airbnb or take larger home equity loans.
- Medical services account for 10% of the young workers' basket to reflect the cost of private insurance. The effective weight is zero for boomers since Medicare covers medical costs for the 65 and above.
- Education accounts for 15% of the young basket and obviously zero for the retired cohort.
- All the other weights are adjusted proportionally: young workers get 15% less of everything else, and boomers get to spend an extra 96% on all the other items in the CPI



With these weights, boomer prices have risen by just 0.5% annually since 2013 while young workers' prices have increased by 1.8%. One does not need to look at the vast differences in wealth to be horrified by theses generational inequality: the gap between boomers' standard of living and that of young workers widens by 2.3%[2] annually. **At this pace, generational inequalities would double every 30 years**. What could stop this time bomb from tearing apart the social fabric? To this we shall turn.



[2] The sum of the differences in wages and inflation between the two groups

A Generational Crossroad

The extent of the economic and social damage (most of which was incurred before the pandemic) will become painfully obvious once the lockdowns are lifted. According to JP Morgan, the unemployment rate should rise to 20% and GDP will should shrink by 40% in the second quarter. Banks will be saddled with non-performing loans. A constant flood of liquidity injections from the Federal Reserve will be required to keep highly leveraged corporations on life support. Default rates on student loans and credit cards will explode. Emerging economies will face deep balance of payment crises, unless the Federal Reserve extends swap lines to very untrustworthy counterparties. Global trade will never recover fully, as countries hastily attempt to resource strategic productions. The economies of Texas, North Dakota, and Oklahoma, where the shale boom had attracted millions of young blue-collar workers, will be devastated by the collapse in oil prices.

Such severe crises usually require a complete overhaul of the social, political, and generational pact. The concepts of nationalism and democracy were born in the bloody streets of the French Revolution. The New Deal arose from the Great Depression. European welfare states were built on the ashes of World War 2. The Social Security Act was passed in the middle of the Vietnam War.

Three paths will branch out from this generational crossroad, whose investment implications are shown on the last page:

- **The "free market purge"** that Austrian economists have been dreaming about since days of the great Keynes v. Hayek debates at Cambridge. The probability of this scenario is exactly zero so I will not spend much time on it, but I have included it for two reasons. First, it amuses me to imagine how President Rand Paul would destroy the administration that he was elected to lead. How much fun would Jim Grant's first (and last) press conference as the chair of Federal Reserve be! I can already picture the confused faces of the suddenly unemployed "economic journalists" as the gold standard replaces the Federal Reserve System.

  Second, the free market purge is an interesting hypothetical scenario because it represents the theoretical outcome if market forces were allowed to follow their course without the constant interventions of bureaucrats and politicians. This course would likely involve a lot of short-term pain, a biblical flood of defaults, and a severe deflation that a stoic population would endure, confident in the certainty that sound money, true prices, limited government, and personal responsibility would eventually restore real prosperity and true meritocracy. A broad coalition of private equity managers, Federal Reserve economists, bureaucrats, tenured university professors, legislators, and defense contractors would surely thwart any attempt to move in this direction.

- **The "boomer ice age"** is unfortunately the highest probability scenario for now. The U.S. would follow the same path as Europe after the sovereign debt crisis: bail out everybody, suppress market prices, and leverage the central bank's balance sheet to ensure that everything stays the same. The European approach is very attractive in the short-term as it cushions the economic devastation of recessions: with the exception of peripheral countries, Europeans generally fared much better than Americans in 2009 and 2010. The European approach would be especially attractive because Covid-19 is "an act of God": the logical reaction is that no one should suffer – or profit – from this catastrophe.

  But whether it is fair or not, this catastrophe has created economic damage: there will be a price for this. The European approach would simply delay its cost by preventing creative destruction, over-regulating economic agents, and maintaining artificially high asset prices. As happened in Europe in the past decade, investment would never recover. Young generations would never be able to buy homes from their elders and thus would not form new households. **Birth rates would drop, generational inequalities would widen, and growth and inflation would never recover.**

Central bankers would respond to the L-shaped recovery by applying more of the same ineffective medicine: rate cuts below the zero-level boundary would keep zombie companies alive. The capital gains from higher bond prices would temporarily bailout pension funds and insurers – at the expense of the long-term sustainability of the system. Politicians would talk (and just talk) about infrastructure packages, the "green new deal", and fiscal stimulus. IMF economists and billionaires would have very serious conversations about the cost of inequalities and the need for inclusive growth once a year in Davos, before happily resuming their comfortable lives.

- **The generational new deal** is the hardest scenario to envision as it will be progressively defined over the course of the next decade. Broadly speaking, a generational new deal would contain three elements.

1- *Limited bailouts*: politicians and voters would realize the futility of trying to restore the world of yesterday. Whether it is fair or not, the post-Covid 19 world will need fewer cruise ships and cars, as fewer workers commute to their offices. Airlines CEOs, who failed to prepare for what should have been a normal business risk after the SARS, avian flu, and Ebola outbreaks, do not deserve to get bailed out. Neither do investors who bought junk bonds in highly leveraged companies, or the private equity managers who sold them. The U.S. bankruptcy system is designed to reorganize failed businesses and transfer their assets into stronger hands. Creative destruction is the true engine of long-term growth: it should be encouraged, or at least allowed.

2- *Large fiscal response*: record low interest rates, mass unemployment, and depressed commodity prices create a generational opportunity to "build stuff" – in the words of entrepreneur Marc Andreesen. Hospitals, dams, 5-G towers, windmills, solar panels … the bigger the better. Austrian types will correctly point out that some of this production will be wasted on bridges to nowhere, pork barrel politics, and the kind of highly visible but uneconomical projects that bureaucrats crave, such as high-speed bullet trains. Encouraging the private sector to build simple things, such as affordable houses near major urban centers, could reduce the risk of wasteful spending.

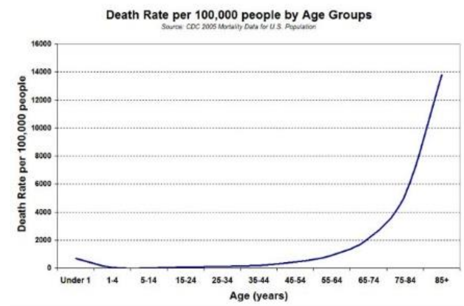
   But ultimately, even wasteful government spending would achieve the goal of injecting money into the economy, provide employment, and eventually kickstart inflation.

3- *Inflationary policies*: **inflation is the only politically palatable solution to the generational crisis**. A decade of high single-digit inflation would wipe out about two third of the outstanding value of all student debt ($1.6 trillion), encouraging household formation, boosting discretionary spending, and eventually reversing the decline in births. A flexible universal basic income would allow the government to target a desired price level much more effectively than the failed monetary policies of the past decade. Protectionist measures would transfer purchasing power from idle consumers (the old) to the working producers (the young).

   The generational inflation gap I mentioned in the earlier part would eventually shrink. Housing prices would fall because of the recession at first, and then thanks to an increase in the supply of affordable homes in tense housing markets. Medicare for all, for which the moral case has never been stronger, would spread the rising cost of healthcare across generations. Medicare for all would also reduce the cost of labor, increase competitiveness, and boost economic flexibility as workers would be able to switch jobs more easily. Last, if the world economy can work on Zoom meetings, so can classes of 30 college students. Colleges have shown true genius to preserve their rents, escape competition, and ignore the technological revolutions of the past 30 years, but Covid-19 may eventually be lethal to university mandarins. The real value of a fancy college education (becoming part of a professional network after graduation, four years of boozing without many responsibilities, and mating with members of the same socio-economic status) cannot be realized on online classes. Students will not pay $56,631 a year to watch Youtube videos, even if they are dispensed at Ivy League universities. Travel restrictions may continue to curtail the flow of wealthy foreign students, whose exorbitant fees keep this inefficient system afloat.

I realize that this agenda may seem like a personal wish list, and that it seems highly improbable over the short-term. However, the "generational new deal" benefits from four powerful tailwinds:

- *Generational turning*: Gen X-ers, Millennials and Gen-Z-ers already outvoted boomers and older generations in the 2018 midterms. This great electoral reshuffling will accelerate exponentially as boomers reach the high death years. **Mortality explodes once a generation passes the age of 65 – which is the median age of the boomer cohort**.

  To paraphrase Hemingway's observation about bankruptcy, the demise of the boomer agenda will happen in two ways: first gradually, then suddenly.

- *Covid-19*: As I argued two weeks ago, "Covid-19 is a generational disease: it kills the old disproportionally and spares the young almost entirely. Conversely, the cost of its "cure", social distancing and economic lockdowns, is borne almost entirely by young workers. The social contract of "social distancing" implicitly demands that the young give up, or at least postpone, their dreams of home ownership, household formation, and steady employment in order to save the lives of the old".

  The generational social sacrifice which was demanded and executed in 2020 has created a moral and social debt from the old to the young. It is unconceivable to me that older generations should insist that the nurses who cured them during the pandemic, or the truck drivers who delivered their food, keep being excluded from Medicare (especially as the program is effectively funded by the younger generation).

  Every generational sacrifice transforms the social contract: universal suffrage, which had been resisted for centuries, became an evidence after the carnage of World War One. World War Two brought generous welfare systems across Western Europe. Similarly, Covid-19 has already blasted open the Overton window for many Millennial / Gen-Z policies, such as universal basic income, debt cancellation and modern monetary theory.

- *Cross-party appeal*: **the generational divide cuts across the left-right political spectrum**. Similarly, part of the generational new deal agenda could appeal to both libertarians and left-leaning populists. Others would please the pro-Trump crowd. Various administrations of different political color will implement the different parts of this agenda, just as Christian Democrats and Socialists built modern welfare states in Europe after the war.

- *Lack of a better alternative*: Necessity is the mother of invention. A decade of European stagnation has shown the limits of the "boomer ice age". The U.S. may be tempted to keep the *status quo*, at least initially. But the cost of propping up a failing system rise exponentially with each crisis: it took five years for the Federal Reserve balance sheet to grow by $2 trillion in the 2008 crisis, versus six weeks in this crisis.

This generational crisis becomes a lot less scary when we realize that it is fought between parents and children, whose fates are tied by necessity and love. It is ultimately a challenge that every prior generation has met. One generation's debt is the other's wealth. The explicit and implicit contracts which organize societies and economies can be amended. At the political level, Europe may have failed to rise up to its debt crisis, but generational relations have been much more harmonious within families: the old have provided housing and financial support to the unemployed young during the great recession of the past decade. The young have not hesitated to sacrifice the timid economic recovery to protect their parents from Covid-19. **History shows that generations eventually find a way of working together, instead of consuming each other**. The nightmares which terrorized Rubens and Goya in the twilight of their lives will dissipate in the bright light of dawn.

A Generational Crossroad			
	Free Market Purge	Boomer Ice Age	Generational New Deal
Probability	0% short-term and 0% long-term	High in the short term, but dropping rapidly	Low in the short term, but rising rapidly
Policy response	Fiscal consolidation and monetary policy normalization	Large monetary response Minimal fiscal response	Large fiscal response Minimal monetary response
Creative destruction	Widespread	Forbidden	Allowed but cushioned by fiscal stimulus
Debt	Paid back or defaulted upon	Rolled over indefintely	Inflated away
Short-term growth	Miserable	Mediocre	V-shaped recovery
Long-term growth	Strong	Mediocre to negative	Strong
Price outlook	Deflation	Deflation first with rising inflationary pressures over time	Inflation
Rates	Low in nominal terms, high in real terms	Negative in nominal and real terms	Low nominal rates rise progressively but remain negative in real terms
Best asset class	First cash, then stocks	Bonds & gold	Stocks & gold
Worst asset class	First corporate credit, then gold	Equities	Treasuries & risk parity strategies
Most favored political constituency	Consumers and entrepreneurs	Rentiers and retirees	Young and poor, working class
Least favored political constituency	Private equity managers and professional rent-seekers	Young and poor	Rentiers and retirees
Favorite equity market themes	Balance sheet strength and business resilience	Healthcare and tech monopolies	Homebuilders, innovation, cyclicals, inflation-sensitive assets
Least favorite equity market themes	Zombie companies with leverage	Banks, cyclicals, and inflation-sensitive assets	Bond proxies

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