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ABSTRACT

The U.S. faces exponentially rising entitlement obligations. I introduce a fiscal limit—a point where higher taxes are no longer a feasible financing mechanism—into a Perpetual Youth model to examine how intergenerational redistributions of wealth, the average duration of government debt, and entitlement reform impact the consequences of explosive government transfers. Three key findings emerge: (1) Growing government transfers cause more severe and more persistent stagflation than in representative agent models that do not capture intergenerational transfers of wealth; (2) A longer average duration of government debt pushes the financing of government liabilities into the future and reduces the short-run impacts of explosive transfers; (3) The time it takes the economy to rebound from a period of growing transfers increases exponentially with the number of years it takes to pass entitlement reform.

Keywords: Finite lifetime, long-term debt, policy uncertainty, fiscal limit, entitlement reform

JEL Classifications: E62, E63, H60, E43

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