

THE CHRONICLE OF HIGHER EDUCATION

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THE MATERIAL WORLD

Debtor Nation

By CLIVE CROOK

The intense financial crisis that started in the American housing market is going to make it difficult, for quite a while yet, to concentrate on remoter issues such as demographic pressures and long-term trends in saving. That is a pity, because when legislators are ready to turn their attention back in that direction, the problems confronting them will be that much worse. Americans are saving less, living longer, and retiring in a cluster. It is a potent combination that will profoundly disrupt the country's economy and politics. The government, the financial markets, and the ordinary households of the United States seem equally unprepared.

Fiscal stress is just one manifestation. Within a decade or so, payments from the Social Security system will exceed tax revenues paid in. Keeping benefits at the present level will eventually require tax increases and/or cuts in other programs. The soaring costs of Medicare — also the result, in part, of demographic pressures — will add hugely to the fiscal burden. The well-trodden line of least resistance to that prospect is to let the budget deficit and the public debt expand. Andrew L. Yarrow's ***Forgive Us Our Debts: The Intergenerational Dangers of Fiscal Irresponsibility*** (Yale University Press, 2008) is a valuable primer on the harm that would do.

Yarrow, vice president and Washington director of the nonpartisan research group

Public Agenda and a visiting professor of American history at American University, explores the implications for taxes, private investment, and growth but puts even more emphasis on the crowding-out effects of Social Security and Medicare on other programs. That is a point that some liberals are apt to miss. Politics puts limits on how high taxes can go. Remorseless pressure from Social Security and Medicare will push taxes and the public debt higher, but it will also squeeze, already squeezing, other public investments — in education and infrastructure, for instance.

Yarrow's approach is appealingly nonsectarian. He calls for a more effective safety net to protect against catastrophic illness, loss of job, and helplessness in old age. But he also urges that citizens be asked to take greater responsibility. An effective safety net, he argues, does not imply "pensions for healthy middle-aged Americans or health-care coverage that pays most costs for almost any care they want." People have an obligation, he argues, to meet the costs of predictable contingencies. To do that, they must save.

But they don't. Ronald T. Wilcox's ***Whatever Happened to Thrift?: Why Americans Don't Save and What to Do About It*** (Yale, 2008) is another useful, slender primer, concentrating not on national choices but on the saving and spending decisions of individuals and households. Its complementary perspective makes it

a good companion to *Forgive Us Our Debts*.

Wilcox, a professor at the University of Virginia's Darden School of Business, starts by affirming that the problem of low personal savings is real — for the economy as a whole but particularly for poor households. Then he turns to causes and remedies. Emphasizing the social psychology of saving, he puts much of the blame for low saving on rising inequality and the consequent demands of keeping up with the Joneses: "The psychology of memory, the sociology of reference-group communication, and the economics of a widening income distribution combine to form a powerful witches' brew of self-defeating consumption behavior."

He has some good, common-sense advice about how to save more intelligently. He calls on companies to do more to encourage their employees to save — for instance, by setting default enrollment policies on 401(k) plans so that workers are included automatically unless they choose otherwise. And he briefly makes the case for an array of policy changes, both large (tax consumption rather than income) and small (improve the marketing of U.S. Savings Bonds). He covers a lot of ground quickly and well.

Missing, I think, is a sufficient emphasis on housing and tax-subsidized mortgage borrowing. Many American families chose to save by accumulating equity in their homes. The government's policy

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was to encourage that through the tax system and in other ways. Then came the housing-market collapse. Falling prices and rising foreclosures have left many households with no savings, no home equity, and no home. The tax regime for housing loans is deeply implicated in the national syndrome of borrowing too much and saving too little.

Three other new books focus more tightly on pensions and retirement. All start from the position that the traditional model of income in retirement — Social Security plus employer-provided pensions — is defunct. The main reason is not forthcoming pressures on Social Security, real as those are, but the demise of the defined-benefit pension.

Roger Lowenstein, one of the country's best financial journalists, gives an absorbing account of that story through three case studies, in **While America Aged: How Pension Debts Ruined General Motors, Stopped the NYC Subways, Bankrupted San Diego, and Loom as the Next Financial Crisis** (Penguin Press, 2008). At the end of the 1960s, 60 percent of the private-sector work force had guaranteed pensions linked to earnings. Today the figure is less than 20 percent. Many of the remaining schemes, public and private, are underfinanced and in jeopardy. Companies have learned from General Motors' calamitous experience, which the book recounts in fascinating detail, and are no longer starting pension plans. In their place is the typically far less generous, and (from the retiree's point of view) much riskier, 401(k).

No pension, meager savings, Social Security and Medicare under strain — in the future, many are

going to find retirement a severe financial shock.

Then why not keep working? Alicia H. Munnell and Steven A. Sass, of Boston College's Center for Retirement Research, examine that question in **Working Longer: The Solution to the Retirement Income Challenge** (Brookings Institution Press, 2008), and explain that the idea is not quite as simple as it seems.

They reckon that three extra years of employment — a shift in the average retirement age from 63 to 66 — would be needed to keep income-replacement ratios at their present level through 2030. That would still leave workers with a longer retirement than was typical a few decades ago. (The average retirement age in 1960 was 66. A man retiring at that age could expect to live another 13 years. Since then male life expectancy has increased by roughly five years.) But the people with the least savings and the greatest need to work longer will be the low-paid, the unskilled, and those in poor health — the very workers who will find it most difficult to keep their jobs.

Munnell and Sass note that the end of the defined-benefit pension has had a further, little-noticed consequence. It militates against "orderly departures" from the work force. "Employers face the prospect of workers with declining productivity and inadequate 401(k) balances hanging on much longer than desirable. Employers will need new tools, including an orderly severance process, to manage an older work force. Without such tools, employers will avoid older workers."

Teresa Ghilarducci, a professor of economics at the New School, rejects the idea that living longer ought to imply working longer. In

When I'm Sixty-Four: The Plot Against Pensions and the Plan to Save Them (Princeton University Press, 2008), she proposes a system to replace 70 percent of preretirement income after 40 years of work. People who wished to work longer could do so, but they would not be forced to by a lack of retirement income. Her key proposal is a mandatory system of guaranteed retirement accounts. Workers not in defined-benefit schemes would put 5 percent of earnings (up to the Social Security earnings cap) into a fund managed by the Social Security Administration; that fund would be invested, and the government would guarantee an inflation-adjusted return of 3 percent a year on each worker's account. A \$600 refundable tax credit would offset the cost for low-income workers. Balances would be converted to inflation-indexed annuities upon retirement.

When I'm Sixty-Four is an excellent book — not the clearest or best written, but the most thorough on the pensions issue — and makes a bold and workable proposal. It calls, in effect, for a combined expansion and partial privatization of Social Security, with a firmly progressive tweak to the tax code thrown in. The guaranteed retirement account itself, which is modeled on the TIAA-CREF scheme for college professors, has much in common, Ghilarducci says, with systems in Sweden, Italy, and elsewhere. There is no financial or economic reason that it could not work — but it is a stretch, politically, as she half-acknowledges. (It might be less of a stretch if she met more-timid reformers halfway and relaxed her opposition to a slightly higher retirement age.)

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Once the present crisis subsides, the retirement-income problem can be solved. The economics is straightforward. All the government has to do is tell voters to pay more taxes, hand over part of their earnings for safekeeping, and work a few extra years.

The difficulty is to propose that solution and still get elected.

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