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Will There be an Egg in the Nest?

Some analysts suggest that the decrease in the number of workers participating in traditional pension plans over time has weakened the typical older household's finances. They say today's older households have not put aside enough in retirement accounts, such as IRAs and 401(k)s, to match the wealth their counterparts two decades earlier held in expected pension benefits. While the methodology used to reach this conclusion is "iffy," today's workers are clearly more responsible for assuring their standard of living in retirement than the last generation. Of course, some will fare better than others.

A recent article in the *New York Times* reported that older households—that is, those headed by people age 47 to 64—have homes that are worth more than their parents' homes were at the same stage of life, have fatter bank accounts, and have seen their average net worth increase by almost 50 percent between 1983 and 2001. Despite this good news, however, the article raised the prospect these workers may not be as well-off as their counterparts were two decades earlier.

How could that be? According to Edward N. Wolff, an economist at New York University, the answer is that a smaller proportion of the work force now participates in traditional pension plans compared with earlier generations. And, contrary to what most studies show, he claims that today's workers have not saved enough in defined-contribution plans, like 401(k)s, to make up for the loss of pension benefits earlier generations enjoyed.

When determining household wealth, most studies look at the average balances of defined-contribution plans. This is misleading, Wolff says, because the averages are biased upward by the extraordinary gains of a few wealthy individuals. Wolff has a valid point. After all, the *average* net worth of an older household amounted to $673,000 in 2001, whereas *median* net worth was a much more modest $199,900. The median meaures the halfway point; half of the households have smaller net worth and half have more. Using the median figure may be more appropriate—the median is less sensitive to "outliers" than the average.

Wolff found that traditional pensions constituted the largest chunk of wealth for the "typical" older household in 1983, followed by home equity and bank deposits. (See Table 1.) Retirement accounts such as IRAs and 401(k)s made up just one percent of this age group's assets. At the time, these accounts were relatively new—while more than two-thirds of older households had someone earning a pension, only eight percent held self-directed retirement accounts.

Turning the clock ahead to 2001, older households were holding slightly more debt on their balance sheets, and a different mix of assets. In particular, the typical household held more of its wealth in retirement accounts and less in pension benefits than in the earlier period. The increase in the former, however, did not offset the decrease in the latter. The bottom line, says Wolff, is that many older Americans are now in poorer financial shape heading into retirement than similar households were 20 years ago.

"Iffy" Methodology?

Calculating wealth is not necessarily straightforward, particularly when it comes to traditional pension plans. For a retirement account such as an IRA or 401(k), the value is simply equal to the cash surrender value. Estimating the present value of pension wealth, in contrast, is more complex. Pension plan benefits are not marketable, and their income streams cannot be translated directly into a current dollar value. Calculating their present value requires making assumptions about future events and conditions (including a person's retirement age, future earnings, and expected mortality), choosing among discount rates, and so on.

Wolff's methodology for calculating household wealth seems biased toward traditional pensions. Although the worth of a retirement account is assumed to be its cash surrender value *now*, in the case of a traditional pension plan, the present value of benefits is calculated assuming that the person *continues working* until his or her expected retirement age. In other words, the study is comparing apples with oranges. A better way of comparing the two assets would be to either: 1) add the present value of expected future contributions to the cash surrender value of a retirement account, or 2) determine the present value of traditional pension benefits assuming that the person had stopped

Table 1: Average Net Worth of Typical U.S. Household*
(Head of Household, Age 47 to 64)

	1983	*2001*
Assets	$244,900	$243,600
Homes	$91,600	$107,300
Stocks, bonds, other securities	4,600	11,300
Bank deposits, cash	31,900	21,900
Other	18,900	17,800
401(k)s, IRAs, etc.	3,200	37,900
Pensions accrued	94,700	47,400
Debt	40,500	43,600
Net Worth (Assets - Debt)	204,700	199,900

* Excluding both the wealthiest and poorest 20 percent; in constant 2001 dollars.
Source: Edward N. Wolff, based on data from the 1983 and 2001 Surveys of Consumer Finances. The *New York Times*.

Table 2: Average Annual Household Expenditures*
(Head of Household, Age 65 and Over)

	1984	*2002*	*% Change*
Average Annual Expenditures	$24,160	$28,105	16
Food	3,884	3,910	1
Housing	7,866	9,176	17
Apparel	1,214	972	(20)
Transportation	4,091	4,481	10
Health Care	2,585	3,586	39
Entertainment	876	1,139	30
Cash Contributions	1,262	1,679	33
Insurance and Pensions	893	1,286	44
Other	1,128	1,876	66
Sources of Income	$24,443	$29,711	22
Wages	5,132	8,218	60
Social Security and Pensions	14,188	17,819	26
Interest and Dividends	3,170	1,704	(46)
Other	1,952	1,970	1

* In constant 2001 dollars.
Source: Bureau of Labor Statistics.

working for the purposes of the calculation.

Social Security benefits were noticeably absent from Wolff's study. For most households, these promised—but not guaranteed—benefits make up a sizeable portion of household wealth and will be the most important source of income during retirement. In another study Wolff prepared for the Economic Policy Institute, older Americans held more than four times as much wealth in Social Security benefits than they held retirement accounts and traditional pensions—combined.

His findings also showed that the average Social Security wealth for households in the 47-64 age bracket fell during the years 1983-89, but then increased from 1989-98. The net effect, however, was a decrease. What happened to the value of Social Security benefits since 1998 and why that information was omitted in his latest study remain interesting questions.

A New Trend

Pensions were originally viewed as a reward for long years of service. Initially, no formal provision for funding them was made—retirees were paid their benefits out of their employers' current income. Employers were not legally bound to pay anything to workers who left their jobs before retirement, nor were they obligated to continue making payments to those who retired.

Although many employers eventually established pension funds, retirement benefits were still vulnerable to fiduciary irresponsibility and bankruptcies. To make sure that workers eligible for pensions received those benefits, Congress passed the Employee Retirement Income Security Act of 1974 (ERISA). The Act set legal standards for plan participation, vesting, fiduciary guidelines, and funding requirements. ERISA also created a Federal insurance system, the Pension Benefits Guarantee Corporation, to pay pension benefits up to certain limits should a company go broke and its plan's assets be insufficient to meet the plan's obligations.

But ERISA raised the cost to employers of sponsoring traditional pension plans, reducing both their numbers and the percentage of the workforce covered by them. Moreover, the benefits of most pension plans have been sharply curtailed from what they once were.

At the same time, the number of defined–contribution plans has steadily increased. These plans are popular among employers because the only thing that is defined is the contribution that employers and/or employees make. In addition, these plans tend to be less complex and costly to administer.

Winners and Losers

What this trend means is that employees—for better or worse—must assume the responsibility for managing their nest eggs. Individual circumstances will vary greatly. Some will amass large accounts, or as Wolff says, do "better than they ever would have under the old [pension] system" and "make out like bandits." On the other hand, others, like the retired Enron pipeline operator who lost $1.3 million when the company imploded, may end up with little or nothing.

But these are the extremes. What we do know from aggregate statistics is that ownership of retirement accounts increases with income and that the median value of holdings in these accounts also increases with income. And although younger households are more likely to participate in a plan, the median holdings for older households exceed those younger households. Those who start saving early, save more, and invest wisely will be better prepared for retirement than those who do not.

Defined-contribution plans also offer workers more flexibility, which may be of great value—again, depending on personal circumstances. For example, the plans are portable, which means that employees can change jobs without giving up part of their benefits. With many pension plans, the prime factors used in the formula to calculate benefits are the number of years of service and the amount of earnings in the final several years—possibly locking workers into jobs they would otherwise leave. Participants can also borrow against their defined-contribution plans, and pass them on to their heirs. Giving individuals more freedom to manage their affairs is a good thing.

What Really Matters

Adam Smith pointed out that the sole end and purpose of activity was consumption, not accumulating wealth. By consumption he meant not only the goods which are necessary to support life, but what "the custom of the country renders it indecent for creditable people, even of the lowest order, to be without." He noted that this could be determined by either calculating what amount of money would be needed to reach this standard or by examining people's possessions to assess whether they maintained a certain level of living.

The perception of the elderly as "needy" is slowly changing to the view that the elderly are better off than other Americans. According to the Census Bureau, only 5.9 percent of households headed by persons 65 and older could not meet all of their "essential expenses" (such as mortgage or rent payments, utility bills, or medical expenses), compared with 14 percent of the rest of the population.

Moreover, households headed by seniors consume 16 percent more goods and services on average in 2002 than their counterparts did 20 years ago, as shown in Table 2. Except for apparel, food, and transporation, which do not tend to be sensitive to changes in income, outlays on the other major components of spending all increased appreciably.

Are we now seeing the "golden age of the golden years?" Maybe. But that possibility is not yet evident in the data. Nonetheless, future generations will increasingly be responsible for how they fare as they get older—and some will have prepared better than others. ❑

IS CHINA A THREAT?

There are significant weaknesses in the Chinese "economic miracle" but, contrary to popular opinion, the way that China is joining the world economy greatly benefits the United States.

China has come a long way since the late 1970s when Deng Xiaoping took over the reins of power. The economic growth of China during the past quarter century has been unprecedented in world history, in terms of both its rate and amount. Annual incomes of the Chinese people, roughly one-fifth of humanity, have more than quadrupled, from about $1,000 per capita to more than $4,000. However, the task of changing to a market economy from a command economy is far from complete.

China has experienced and continues to experience a huge internal migration from rural areas to the cities. The number of persons believed to be leaving farms for the cities has been estimated to total 10 million people a year. This process is difficult and has much farther to go—well over 50 percent of China's population continues to reside in rural areas.

With its huge population of 1.3 billion, small percentages translate into very large absolute numbers. To illustrate, the official estimate of the unemployment rate increased from 2.6 percent in 1993 to slightly over three percent at year-end 2000. This may seem very low, almost inconsequential by our standards, but it translates to more than 20 million unemployed Chinese.

Moreover, most observers believe that the official statistics vastly understate the extent of unemployment in China. In just the past six years, according to the *Peoples Daily,* China's state-owned enterprises (SOEs) have laid off more than 28 million workers. (By way of comparison, the employees of U.S. goods-producing industries now total slightly below 22 million, down by about three million from its peak.)

State-Owned Enterprises Remain Dominant

Despite the many millions of layoffs, SOEs still account for an estimated 60 percent of Chinese output. Dismantling them and making them economic is not an easy task. They represent a huge opportunity cost to the Chinese economy. Bank loans to SOE's are often simply subsidies to cover losses and are unlikely to be repaid. Bad loans represent a continuing drain on capital formation. Similarly, the bloated payrolls of the SOEs keep productivity levels low. The problem is that, under the Maoist system, SOEs provided workers with housing, medical care, and other services. Replacing such functions of SOEs with government services and safety nets has not been an easy or rapid process. Also, local government officials are often reluctant to dismantle SOEs because they represent a major source of patronage and power.

Thus, for the transition to a market economy to be politically acceptable, the rate at which SOEs can be restructured is highly dependent on the rate at which new private sector jobs are created. To date, foreign direct investment (FDI) has been the major source of jobs for former employees of SOEs and migrants from the countryside.

According to George F. Gilroy, "China allows foreign firms to invest in its domestic markets on a scale unprecedented in Asia. Since it launched reforms in 1978, China has taken in $500 billion in FDI , ten times the total stock of FDI Japan accumulated between 1945 and 2000."* Much of the FDI in China has come from "overseas" Chinese around the world, but China's Ministry of Commerce has reported that U.S. firms have invested more than $40 billion in more than 40,000 projects in China. Gilroy states that, "China cannot maintain its domestic market as a protected bastion for domestic firms, something both Japan and Korea did during their periods of rapid growth." Foreign firms have come to dominate China's industrial exports, especially the "high tech" exports (see table below), and have strong positions in China's domestic markets. The managers of Chinese firms have a culture that "encourages them to seek short-term profits, local autonomy and excessive diversification…. Chinese firms focus on developing privileged relations with…the Chinese Communist party hierarchy, spurn horizontal association and networking with each other and forego investment in long-term technology development and diffusion." These factors "severely limit the country's ability to wield technological or trading power for unilateral gains."

Gilroy concludes that "Recent debates about U.S.-China trade overlook the fact that the U.S. economic relationship with China is largely favorable and that it is conducted mainly on U.S. terms." Although employment adjustments are painful, the United States has benefited greatly from China's joining the world economy. Moreover, because its particular situation has forced it toward an open economy and to become a major importer, China is becoming a major ally in many areas of global trade and finance.

Challenges Ahead

However, China must overcome many challenges if it is to continue its advances. In addition to the problems of grossly inefficient SOEs and the influx from the countryside to the cities, future growth will be increasingly constrained by corruption, inadequate infrastructure, weak financial institutions, and the political rigidities of a one-party state.

This last problem could well be the most intractable. As noted above, regional and local party officials have great power in their domains and they are loath to give it up. They are used to receiving bribes and to seizing property from the peasants at will. Attempts to curb the power and abuses of these officials could lead to the political instability that the central government fears most, not only because it could threaten their own power and privileges, but also because it could cause an end to the flow of foreign investment on which its recent economic advances have heavily depended. ❑

* *Foreign Affairs*, July/August 2004, p. 37.

Exports of "High Tech" Equipment From China

	Industrial Machinery		*Computers, Components, and Peripherals*		*Electronics, and Telecommunications Equipment*	
	1993	*2003*	*1993*	*2003*	*1993*	*2003*
Value of Exports ($Billions)	$4.2	$83.0	$0.7	$41.0	$12.3	$89.0
Manufacturer						
State-Owned Enterprises	64%	15%	26%	6%	54%	18%
Wholly-Owned Foreign Enterprises	17%	62%	51%	75%	15%	43%
Joint Ventures & Co-production	15%	17%	23%	17%	30%	31%
Other	4%	6%	0%	2%	1%	8%

Source: Customs General Administration, PRC.

PROPERTY RIGHTS AND FREEDOM

This article is by Mark Gerson, a participant in the 2004 AIER Summer Fellowship program. This fall he will be entering graduate school in economics at the University of California at Berkeley.

Every culture has certain unspoken values that go unquestioned. America is no different. In our society property rights are perhaps the most significant such value, but they are unspoken, rarely seriously challenged, and rarely popularly discussed. This stands in contrast to other issues, which receive their fair share of attention, such as diversity, manifest destiny, immigration, or gender differences. This is precisely because property rights are seemingly so secure in the United States.

A priori, however, there is no reason to assume that society should have "secure property rights" in the American conception. We might instead require that a citizen be found "moral" in order to hold property, lest society offer sanction and power to those sorts of people with which it would be best not to associate. We might also assign property rights to all "the people" (or analogously, to none) so that no one would be excluded. Or we might require a limited form of governmental or community "review" or perhaps a conference of "stake holders," to ensure that private property rights do no enshrine any particular social benefit, but rather, allow for the flourishing of freedom. Indeed, the development of the American conception of property rights is inextricably linked to the political pursuit of freedom.

The origins of the political struggle for liberty that resulted in our current conception of property rights may be found in England, particularly in the Coronation Oath of Henry I (1101) and in Magna Carta (1215). Both documents proscribe the King from infringing upon property rights but in accordance with custom and due process of law. The Summons of the Model Parliament in 1295, confirmed that taxes could be raised by Parliament, "the common council of the realm." These documents are formative in our conception of property rights because they recognize the importance of limiting the Crown's ability to take private property.

To paraphrase Hobbes, the Crown was much like the "strongest man" in the state of nature, but with a benevolent streak: it provided order for the benefit of lesser men, but still dangerously sought its own advancement by unjustly taking private property, for example, by levying fees beyond that permitted by custom. Our conception of property rights is therefore informed by the imperative of preventing the Crown (or the government) from overstepping its role in providing order, as opposed to any competing view of property rights which would emphasize the need for the government to override the privileges of private property for a common good, however defined. This view would be recapitulated, and expanded, in the Levellers Agreement of the People (1647) and in the English Declaration of Rights (1689) following the Glorious Revolution.

John Locke

Also at the end of the 17th Century, John Locke systematically analyzed the link between property and liberty in his treatise, *Second Essay on Civil Government.* This link is made most obvious by Locke's notion that every man has a right of property in his own person, and consequently, in his labor and those things mixed with his labor. After observing that the principle of civil society is the preservation of property against injury, Locke goes on to explain that the government cannot take any part of a man's property without his consent. If the government carries out non-consensual takings, then it leaves a man without any private property at all, for he then holds his property by whim of the government, and not by any natural right. In this way, Englishmen learned that property rights and liberty are each necessary for the other, an idea which was in the forefront of the consciences of the intellectual leaders of the American Revolution. As expressed in *Cato's Letters*, a popular source of ideas in colonial times, property is the necessary support for a man's independence, without which he would be a servant of others. That property, however, is the "effect of Liberty alone, and can only be secured by the Laws of Liberty."

This intertwined notion of Liberty and Property, intellectually descended from John Locke, inspired the assertion most commonly linked with the American Revolution: "No taxation without representation." The most popular stories of American resistance are those of tax rebellions: the Sugar Act was met with "non-importation" (boycott); the Stamp Act both with coercion against would-be stamp agents and the Stamp Act Congress, the Townshend Acts with the renewed non-importation as well as the Circular Letter and Virginia Resolutions; and the Tea Act inspired the famous incident in Boston Harbor. This active protest against what, today, would be considered minor taxes was inspired by Locke's idea of liberty and property: without representation in Parliament, the colonists could not consent to be taxed, and Parliament's assertion of its right to tax the colonies therefore jeopardized all of the colonists' property rights and liberty. Furthermore, such taxation constituted a broad-based threat to the emerging colonial middle classes, which could not hope to attain wealth (and thus gentleman status) without secure property rights.

The Virginia Declaration of Rights, which later influenced the American Bill of Rights, may therefore be viewed as a response to Parliament's infringements of the rights of the colonists. It is for this reason that George Mason expressly states that all power is derived from the people, and that magistrates are "at all times amenable to them," which Mason notes *after* affirming the unalienable right to acquire and possess property. These ideas are fundamentally Lockean, and are representative of the colonists' desire to defend their natural rights, as articulated by Locke, where property is necessary for liberty.

This linkage is also reflected in initial property qualifications for voting, which ensured that eligible voters were not dependent on others; only by owning property could one be independent and be capable of making a free choice, independent of a master or employer. Although such qualifications were viewed as anti-democratic by the descendants of the Fathers, they viewed such restrictions as being fundamentally in line with the ideals of property rights which had fueled the Revolution. Only by mixing one's labor with one's own land could one acquire the ability to properly decide its future—a future which, after the tumultuous period between 1776 and 1787 had ended, would be the future not of one isolated colonial manor, but of a vibrant and free United States.❑

PRICE OF GOLD

	2002	*2003*	—— *2004* ——	
	Aug. 8	*Aug. 7*	*Jul. 29*	*Aug. 5*
Final fixing in London	$312.15	$351.60	$387.30	$390.85

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