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Economic Trends

By Margaret Popper

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They Really Were Golden Years

Anger over mounting medical bills has obscured a simple fact: The elderly prospered in the 1990s. According to new census data, poverty among those 65 and older fell much faster than among other age groups during the decade. Seniors did have higher medical expenses. But that was offset by income gains. Just 9.9% of the elderly were below the poverty line in 1999, down from 12.8% in 1989 (chart) and 25.3% in 1969.

Other age groups did not fare as well in the 1990s. The poverty rate for children under 18 dropped from 17.9% to 16.1%--a big decline, but still smaller than the drop for the elderly. And the poverty rate for ages 18 to 64 actually rose slightly, from 11.2% in 1989 to 11.3% in 1999.

Many people who retired in the 1990s absorbed only a small hit to their living standards. The average replacement ratio--retirement income as a share of peak aftertax lifetime income--approached 87% in 1999, reports a study by James P. Smith, a Rand Corp. economist. That's up from about 80% in 1989.

For the poor, the transition to retirement was especially seamless: After paying taxes, households in the lowest 25% income bracket had retirement income equal to pre-retirement income, reports Smith. The bear market in stocks affected only the top 30% or so of America's elderly. "The remainder never had much wealth," he says. As a group, "this [current] generation of elderly will probably have it the best of any generation, either before or after," says Edward N. Wolff, New York University economist.

In fact, there are signs that the current decade is not shaping up as well for old people. Unlike in the 1990s, rapidly rising health-care costs are not expected to be offset by rising retirement incomes. By 2005, the elderly will spend 25% of their income, on average, on medical expenses, including premiums for Medicare, estimates Marilyn Moon, a senior fellow at the Urban Institute, a Washington think tank. That's up from 22% in 2000. "Health-care costs will continue to rise as a share of people's incomes, no matter what," she says.

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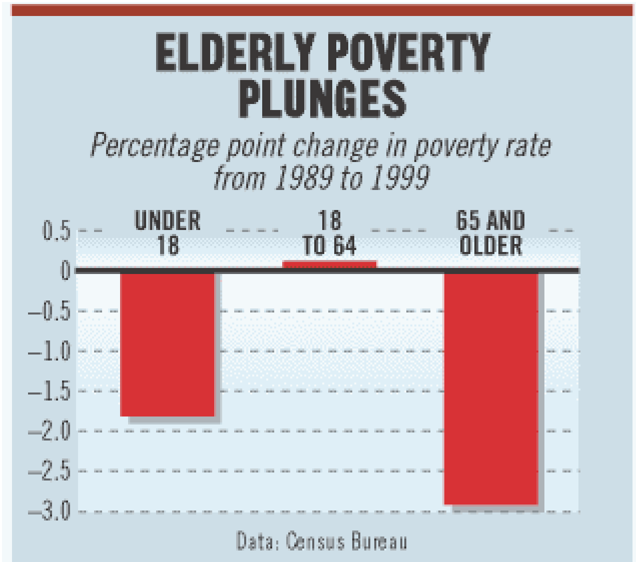

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Is This Tax Cut Cutting It?

Tremendous dispute still exists among economists about whether the 10-year, $1.4 trillion tax cut signed by President George W. Bush in June, 2001, will be good for the U.S. economy over time or not. A study by Alan J. Auerbach, an economist at the University of California at Berkeley, suggests that the tax reduction could boost the net national savings rate in the short term but lower it in the long run, possibly slowing economic growth.

The net national savings rate is a share of gross domestic product excluding depreciation. It includes such things as personal savings and undistributed corporate profits, minus government budget deficits. If spending behavior doesn't change, the tax cut would do nothing to alter the national savings rate. Any increase in household after-tax income would go right into savings. But that would be offset dollar for dollar by a rise in the federal budget deficit.

Auerbach, however, argues that spending behavior will change. He says people in the short run likely will save more than a dollar for each extra dollar they get from the tax cut, taking advantage of higher disposable income now to salt away more money. This scenario--one of several in his study--assumes that Congress won't change the tax law before 2010, and that afterward, Congress will wipe out the deficit solely by raising income taxes. Since people know the windfall won't last past 2010, there will be an extra impetus to save now, says Auerbach.

After 2010, Auerbach thinks the national savings rate will start to fall, eventually dropping well below today's level. That, he thinks, will make it harder to finance investment and will slow the long-term growth rate of the economy. Auerbach's compromise: Don't create such big deficits. Make smaller but permanent tax cuts.

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America the Transparent

Bad as the recent accounting scandals in America have been, U.S. companies still report their profits more accurately than those in any other country, shows a study by finance professors Utpal Bhattacharya of Indiana University and Hazem Daouk of the University of Michigan, and accounting professor Michael Welker of Queen's University in Kingston, Ont.

Using data from nearly 60,000 companies from 1985 to 1998, the authors ranked 34 countries on three negative criteria: "earnings aggressiveness," or booking gains early and losses late; "loss avoidance," or tweaking the timing of results to turn small losses into small gains; and "earnings smoothing," cooking the books to suppress both large gains and large losses. The more companies in a given country exhibited any of these traits, the lower the country's transparency ranking.

The U.S. had the highest overall rank for earnings transparency (chart), and it ranked among the top six countries on each of the three criteria. Its lowest ranking, sixth, was on earnings aggressiveness.

So far, the U.S. reaps the advantage of a lower cost of capital from this perception of transparency. Bhattacharya estimates that the cost of capital is about 3% lower for a typical country in the top half of the rankings than for one in the bottom half. Bhattacharya also says that although he doesn't have international data since 1998, he believes that U.S. companies still have the most transparent accounts, scandals notwithstanding.

THE U.S. STILL SETS THE STANDARD

Earnings Transparency of the G-7*

RANK	COUNTRY
1	U.S.
7	CANADA
8	FRANCE
11	BRITAIN
15	GERMANY
27	ITALY
29	JAPAN

*Rank among 34 countries based on how well reported profits reflect actual results

Data: Bhattacharya, Daouk, Welker

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