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Macroeconomic dimensions of social economics: Saving, the stock market, and pension systems

by

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Macroeconomic dimensions of social-economics:

Saving, the stock market, and pension systems [1]

By Martha A. Starr

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Abstract

Saving, investment, and pensions are avenues by which households build up claims to future income and consumption. Such claims are important in a number of respects: they broaden people's options, reduce their insecurities about material living standards, and enhance their ability to live with dignity in old age. As such, understanding the multiplicity of factors that shape how people save, invest and acquire pension rights is important for understanding their access to well-being and the ways in which social arrangements improve or undercut that access. This paper reviews social-economics perspectives on these macroeconomic issues, highlighting contributions of existing research and identifying fruitful directions for future work.

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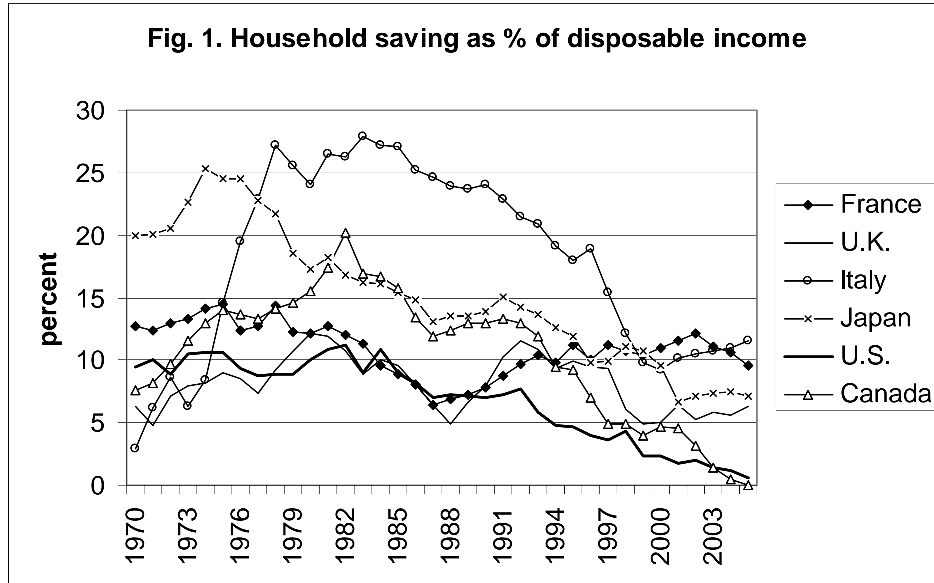
[1] Prepared for J. Davis, W. Dolfsma, E. Oughton and J. Wheelock eds., *Elgar Handbook of Socio-Economics.* Please address correspondence to: Martha A. Starr, Department of Economics, American University, 4400 Massachusetts Ave. NW, Washington, DC 20016. phone: 202-885-3747. email: mstarr@american.edu. I'm grateful to Adam Seitchik of Trillium Asset Management for his valuable insights on socially responsible investing.

Saving

In the traditional lifecycle view of saving, households maximize utility over the lifecycle, resulting in a profile whereby they borrow when young, save in mid-life, and spend down their assets when older; then total household saving is aggregated up from the behavior of independent households. Social economists share the criticisms of this perspective found in other fields, including feminist economics, behavioral economics, post-Keynesian economics, and economic methodology, which include: (1) the representation of households as monolithic, ignoring issues of gender and power within the household (Ferber and Nelson 1993, Floro and Seguino 2003); (2) conceptualizing cognition as general-purpose and powerful, rather than an assembly of special-purpose processes subject to limitations (Simon 1955, Thaler 1994, Dietz and Stern 1995); (3) ignoring possibilities that differential saving across the income distribution may push aggregate supply out of balance with aggregate demand (Hobson 1910, Ryan 1935, Yunker 1997, Froud 2001), and (4) more generally, the problem of refuting a theory of behavior that only needs people to act "as if" the theory explains their behavior (Davis 2003).

Other alternative views of saving are more unique to social economics. First, whereas traditional theory takes preferences involved in consumption and saving to be given, social economics emphasizes how important social and cultural factors are in shaping how people perceive and value alternatives and decide amongst them (O'Boyle 1994, Davis 2003, Lee and Keen 2004). Issues of potential importance here include socio-cultural norms that favor high consumption (Veblen 1994[1899], Duesenberry 1949, Schor 1999, Shipman 2004), the role of advertising in promoting spending (Galbraith 1958), and public discourses of values like thrift and self-control (Ryan 1935, Tucker 1991, Starr 2005). Some evidence suggests that such factors have contributed to the slide in household saving rates in many OECD countries the past 25 years (see Figure 1): notably, studies using survey data for the U.S. show a broad-based decline in saving across all socio-demographic groups, consistent with a general cultural phenomenon like an increase in the discount rate (Bosworth et al. 1991; Parker 1999).[2] More work should be done to understand relations between preferences, culture, and economic forces, and the ways in which they may fuel problems of unsustainable consumption in industrial countries (Norgaard 1995, Røpke 1999, Jackson 2004).

[2] Another factor contributing to the decline in saving has been rising prices of assets owned by households, namely homes and stocks (Parker 1999; Lusardi, Skinner, and Venti 2001; de Serres and Pelgrin 2003).



Source: OECD.

A second departure from the standard approach concerns the *a priori* framing of consumption and saving as matters of autonomous households looking after themselves. Clearly, ties with broader networks of family, friends, and neighbors, and with voluntary and community organizations, at least potentially provide a wealth of extra resources that people can call on in times of need, and to which they may contribute. Thus, Guerin (2003) speaks of the need for putting a 'radical socialness' into our understanding of consumer behavior. Mainstream discourse is not oblivious to this point, as the large literature on strategic vs. altruistic transfers attests.[3] However, for social economists the question is not whether people are 'essentially' social or 'essentially' self-interested -- but rather how, when, and why social dimensions of behavior come to be favored (Lutz 1990, Davis 2004).

Third, whereas the traditional view makes no distinction between wants and needs, the acceptance of 'needs' in the social framework (involving both social and biophysical dimensions) adds complexity to the analysis of saving behavior.[4] In the traditional view, the level of a household's income does not affect its saving: both low- and high-income households save to smooth consumption over the lifecycle, so the savings behavior of former will just be a scaled-down version of that of the latter, as long as their lifetime earnings profiles have the same shape. However, if needs must be met before income can be allocated to saving, certain groups of people may find it impossible to save. Thus, within populations of wealthy countries, we would expect to find little saving among households with low incomes, many mouths to

[3] See for example Behrman et al (1995) or Altonji et al. (1997).
[4] See Haines (1990), O'Boyle (1993), and Trigg (2004) for discussion of 'needs'.

feed, uninsured medical expenses, etc.; across countries, we would expect saving rates to be lower among countries with relatively poor populations. While both of these implications are supported by the data (Friend and Schor 1959, Leff 1969, Bunting 1991, Paxson 1996, Huggett and Ventura 2000), the role of needs in explaining them remains to be established. Thus, for example, Hubbard, Skinner and Zeldes (1995) argue that low-income households in the U.S. fail to save, not because of inability to do so, but rather because asset-based means-testing for social-insurance programs effectively penalizes saving; the policy implication that low saving can be 'solved' by removing disincentives would just increase hardship if failure to save in fact reflects inability to do so. Understanding how needs are involved in inability to save is particularly important for policies related to pensions and social security, as will be discussed below (see below).[5]

Stock markets

Social-economic analysis of stock markets highlights that, rather than being forums for exchange whose origin and position can be taken for granted, stock markets are institutions, constructed and regulated by people, that need to be seen in terms of the social and economic relations in which they are situated. There are three dimensions to looking at the stock market through a social lens.

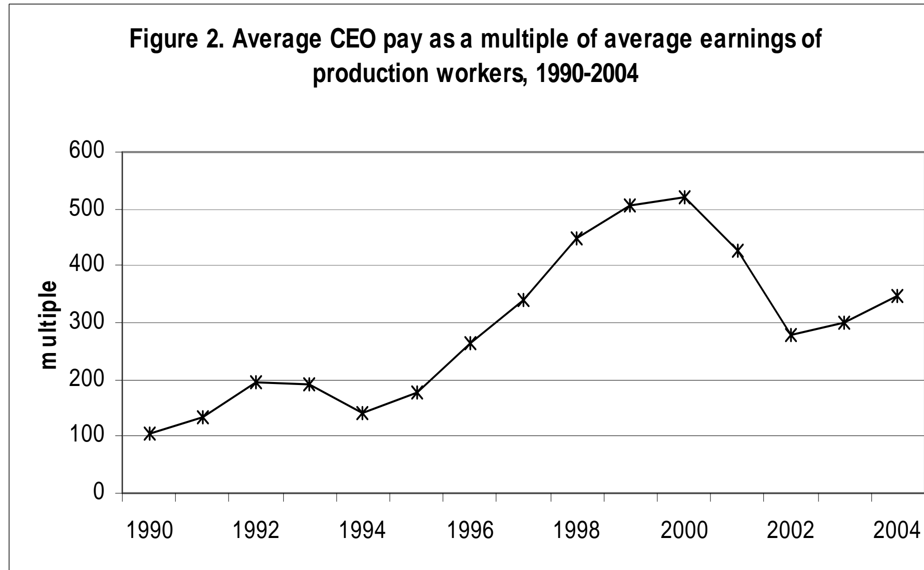
The first concerns the conduct of the market itself. Standard narratives of how financial markets work can give such minimal attention to human and social factors that they can resemble descriptions of how atoms behave in particle accelerators, more than representations of activities organized and carried out by humans. Yet trading is carried out by people whose reasons for behaving may or may not include things other than making the most possible amount of money, and whose behavior is shaped by legal and institutional constraints and socially determined rules. Thus, Abolafia (1996) studied the social dynamics among traders in stock, bond and future markets, highlighting the importance of social and institutional factors in understanding how these markets work, including "the strength and efficacy of reputational and trust networks among buyers and sellers, the shifting balance of power among stakeholder groups in the market, the strength and efficacy of institutionalized norms and rules of exchange, and the role of state intervention in shaping market relations" (p. 190). Also of interest to social economists are ethical dimensions of financial transactions and their

[5] Beverly and Sherraden (1999) consider institutional approaches for promoting saving among low-income households.

intersection with law and regulation; see, for example, John Ryan (1935) on speculation, and Phillip O'Hara (1999) on insider trading.[6]

Second, stock markets are associated with a way of structuring relations of production that shapes the distribution of power and wealth in industrial societies. An important issue here is the separation of ownership and control associated with the growth of large-scale enterprises: from the mid-19th century on, railroads and mass-production businesses required such great amounts of capital that large pools of investors were needed to finance them, and responsibility for managing operations was delegated to executives (Veblen 1908, Berle and Means 1932). This separation is potentially a source of efficiency problems insofar as incentives of managers may be imperfectly aligned with those of shareholders (Fama and Jensen 1983). But it also creates important equity problems, in that it bestows considerable power and authority on a privileged executive class. Concerns about equity flared in the 1990s when average CEO pay skyrocketed, reaching 300 to 500 times the earnings of average workers in the U.S. (see Figure 2).[7] Social economics has valuable insights to offer on the question of whether such extraordinary income differentials should be tolerated on ethical grounds. For example, the 1986 Pastoral Letter of the U.S. Catholic Bishops argues that people do not have a right to unlimited incomes when the needs of others are unmet.[8] John Ryan (1916: 226-227) argued that most cases of large profits arise in markets that are uncompetitive in structure or conduct, and so should be addressed by enforcing appropriate economic policies; but when large profits are fairly earned, they should be paid out to "active workers, from the president of the concern down to the humblest day laborer, [since] this arrangement would return the surplus to those who had created it and would prove a powerful stimulus to sustained and increased efficiency." More work could be done to use such insights to develop conceptually rigorous approaches to the ethics of CEO pay.

[6] See also Williams et al (1989).
[7] Multiples also rose in other industrial countries, though not to the same extent as in the U.S. See Conyon and Murphy (1998) for comparison of the U.S. and U.K.
[8] The Bishops (1986) write, "Support of private ownership does not mean that anyone has the right to unlimited accumulation of wealth … 'No one is justified in keeping for his exclusive use what he does not need, when others lack necessities'." The second sentence quotes from Pope Paul VI's encyclical, *On the Development of Peoples* (March 1967). See also Barrera (1997).



Source: Author's computations using *Business Week*'s annual Executive Pay Scoreboard (usually published in April) and the Bureau of Labor Statistics data on average weekly earnings of production workers (multiplied by 52 to convert to an annual basis).

The structuring of relations of production associated with stock markets also entails an exclusion of employees and communities from power or voice in control of the productive process -- something Jon Wisman (1988) had identified as a central problem of industrial democracies. Framing the employees of a firm as doing nothing other than supplying labor services denies that part of the value of the firm's capital was created by its employees (U.S. Catholic Bishops 1986). It also both conceals and reinforces the problem that worklife in large organizations can have limited intrinsic value: when what is needed of a worker is defined by his/her position in the complex structure of the firm's operations, there may be minimal opportunities for creative contribution, self-development, self-expression, or realization of self-worth.

Thus, a number of schemes have been explored as ways of fostering more participatory forms of organization that acknowledge and promote workers' integral contributions. The most comprehensive is the idea of worker-owned and –managed firms, in which employees run all aspects of the firm's operations; they may also build ties with surrounding communities (see Ellerman 1986, 1993; Gunn 2000; and the chapter on 'economic democracy' in this volume). Other schemes entail less radical changes in organizational form while still aiming to insert workers into the discourses of owners and managers. These include employee stock ownership plans (ESOPs), whereby workers can buy stock in the company; profit sharing plans, in which

workers get a bonus linked to firm performance; and stock options, which permit employees to buy company stock at a favorable price in a specified period of time.[9]

Available research suggests that these kinds of participatory programs tend to be associated with greater employee well-being -- although to bring about appreciable improvements, they are best combined with broader efforts to restructure decision-making within the firm (Freeman, Kleiner, and Ostroff 2000; Morehouse, Speiser and Taylor 2000: 70). Interestingly, when used blatantly as incentive devices, stockownership and profit-sharing schemes can actually erode productivity and morale; rather, they seem to work best when they underline the intrinsic value of work (Frey 1997a, b; Arocena and Villanueva 2003). However, an undesirable consequence of such schemes is that they create a strong positive correlation between workers' labor earnings and their financial assets. Thus, for example, when the Color Tile Company went bankrupt in 1997, workers both lost their jobs and saw the value of their retirement accounts plummet, since the latter were invested overwhelmingly in company stock (Wiatrowski 2000, Muelbroek 2002).[10]

Thus, other schemes hold up broad-based, diversified stock ownership as a means of shifting workers out of subordinate, excluded positions in relations of production -- and into positions where they can share its fruits more fully. In the U.S., ideas such as those in Kelso and Adler's (1958) *Capitalist Manifesto* and Speiser's program for a Universal Stock Ownership Plan have figured into public discourse about how to humanize the economy and improve its moral footing, although the profound sorts of changes they advocate make them difficult to get off the ground (Morehouse, Speiser and Taylor 2000). More recently, in transition economies it was hoped that 'voucher privatization' would pave the way to a participatory capitalism in which the benefits of free-market growth would be widely distributed. For the most part, these schemes failed to work as planned, as the general public sold its asset claims (whose values were then highly uncertain) to small groups of investors (Black, Kraakman, and Tarassova 2000).

Even so, stockownership has been rising in the industrial world due to ongoing trends: the growth of mutual funds, the introduction of tax-deferred retirement accounts with investment options, and a long period of rising prices (Guiso et al. 2002). Stock ownership is most widespread in the U.S., where almost half of all households owned stock in some form in 1998,

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[9] According to the U.S. Bureau of Labor Statistics (2004), in 2003, 5% of private workers participated in an ESOP at their current workplace, 5% received cash profit-sharing bonuses, 26% participated in a deferred profit-sharing plan, and 8% had access to stock options.

[10] As Bowles and Gintis (1996) point out, this problem of increasing risk to workers would not be such a problem if the distribution of wealth were more equal.

up from one-third in 1989 (Bertaut and Starr 2002: 190).[11] Still, this increased ownership has had negligible effect on relations of production because it involves no change in participation in decision-making, and because stockownership remains strongly concentrated in the high end of the wealth distribution; for example, in the U.S., two-thirds of the value of total stock owned by households was held by those in the top 5% of the wealth distribution in 1998 (Bertaut and Starr 2002: 196). This illustrates that the idea, expressed for example by Marshall in 1923 (p. 68), that ownership of stock by "multitudes of small capitalists" would "strengthen the position of the middle classes relatively to the working classes on the one hand and to the wealthy classes on the other" has never been very close to the truth.

A third dimension of stock markets of social-economic interest is the role of ethical and social factors in decisions of investors. Starting with efforts to promote divestment from South Africa during the apartheid era (Lashgari and Gant 1989), a growing segment of stock-market investors has come to make investment decisions based in part on the ethics of a company's products and/or business practices, in addition to considerations of risk and return. 'Socially responsible investing', or SRI as it is known, had initially involved staying away from companies of certain types: those that profit from addiction (tobacco, alcohol, gambling), deal in means of violent force (weapons, defense services), exploit sweatshop labor, operate in countries which abuse human rights, have poor labor practices, treat animals inhumanely, use environmentally unsound production methods, and/or produce products with adverse environmental effects (Bruyn 1991). Now SRI also involves 'positive' as well as 'negative' screening, that is, deliberately seeking out and favoring companies that use socially-responsible practices or produce products that are socially beneficial. In the U.S. in 2003, about $2 trillion was managed with social responsibility taken into account, representing about 11% of the value of financial assets under professional management; while foundations, church pensions, and charities represent an important part of the social investment movement, SRI funds are increasingly being offered as an investment option in 401(k)-type retirement plans (Social Investment Forum 2003). To date, only a few economic studies have investigated the effects of SRI on companies' behavior. Teoh et al (1999) found that, although the South African boycott did not push down the stock prices of targeted companies (apparently because institutional investors bought stock that socially-concerned investors were unloading), targeted companies did shut down their South African operations, leading the authors to conclude that

[11] For comparison, for the most recent year for which data were available, the share of households owning stock directly or indirectly was 34% in the Netherlands (1997), 32% in the U.K. (1997-98), 19% in Germany (1993), and 19% in Italy (1998). See Guiso et al. (2002: 11).

SRI should be thought of as a "powerful and effective means to achieve social change." More economic research on the effects of SRI would be valuable.[12]

Pension systems

As the fields fear drought in autumn, so people fear poverty in old age.

-- Chinese proverb

Before the advent of old-age pension systems, the lives of older people were often ones of insecurity and deprivation: decreasingly able to work, but not necessarily having savings or the care of family members to fall back on, many older people reduced their spending to minimal levels, in line with their limited means. Addressing the problem of old-age poverty was a central concern of social-insurance programs put in place by industrial democracies over the course of the 20th century. As U.S. president Franklin Delano Roosevelt said upon signing the Social Security Act of 1935:

> The civilization of the past hundred years, with its startling industrial changes, has tended more and more to make life insecure … We can never insure 100% of the population against 100% of the hazards and vicissitudes of life, but we have tried to frame a law which will give some measure of protection to the average citizen and to his family against the loss of a job and against poverty-ridden old age.[13]

Public-pension programs have been highly effective in reducing poverty in old age; in the U.S., for example, the poverty rate among people aged 65 and older fell from 30% in the mid-1960s, when social-security benefits were made more generous, to about 10% in the early 2000s (Figure 3).[14] Because most public-pension systems replace only 40-60% of the worker's pre-retirement pay,[15] some private employers also provide pension coverage to close the gap. Private pensions may be either *defined-benefit* plans, which provide a set monthly amount paid indefinitely based on years of service and salary level, or *defined-contribution* plans, where the employer and/or employee contribute to a retirement account, usually on a tax-

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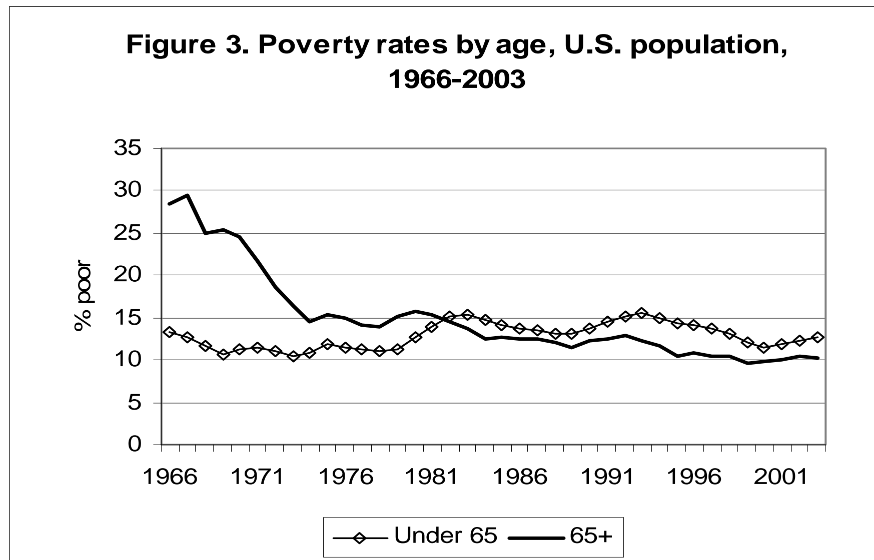
[12] See also Elliott and Freeman (2000) and Rock (2003). There is a substantial body of financial research on SRI, including Sauer (1997), Statman (2000), and Derwall et al. (2005).
[13] Presidential Statement, August 14, 1935.
[14] As incomes have risen around the world, so too has the number of countries with public-pension systems: as of 1999, 167 countries had such systems, up from 33 in 1940 (U.S. Social Security Administration 1999). Programs are most comprehensive in advanced-industrial countries, where over 90% of the work force is eligible for benefits. Coverage is much less complete elsewhere; for example, public pensions cover 10% of the work force in Zambia, 30% in Korea, and 50% in Brazil (U.S. Census Bureau 2001: 117).
[15] However, some countries have more generous benefits -- as in Greece, Italy, Portugal, and Spain, which have average replacement rates above 80% (OECD 1998).

deferred basis.[16] The importance of private pensions in retirement income varies considerably across countries, in part reflecting differences in the ability of organized labor to win pension promises from employers; uniformly, however, men are more likely than women to be covered under private pension plans.[17]



Source: U.S. Census Bureau, Current Population Survey, Annual Social and Economic Supplements.

An important policy issue concerns the expectation that in coming years, public-pension schemes will become increasingly difficult to sustain fiscally due to population aging. Slowing rates of population growth and rising life expectancies have increased the shares of older people in the populations of industrial countries (see figure 4); with such trends expected to continue well into the 21st century, expenditures on pensions are expected to become increasingly burdensome relative to national output (OECD 2003). There is much debate, however, about whether radical measures are required to address this problem. Possible changes under discussion include reducing early-retirement options (a particularly important possibility in Europe since such options are widely used), increasing the normal retirement age, notching up payroll taxes used to finance pension payments, and scaling back payments to wealthy retirees. Measures of a more radical nature favor increasing reliance on private saving for retirement. The outcomes of this policy debate are important because many people depend

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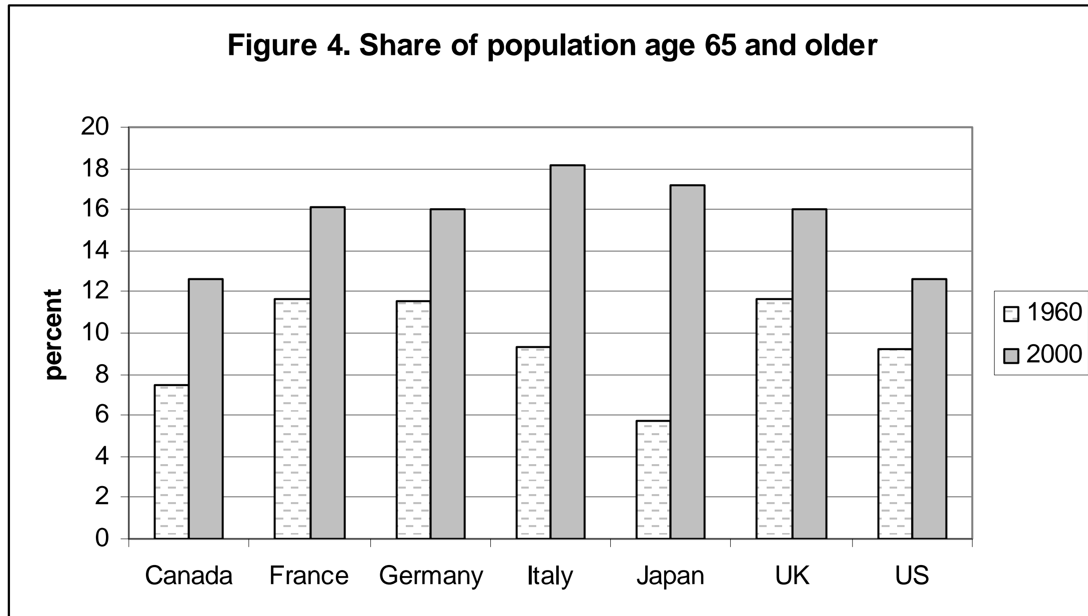
[16] While coverage under defined-benefit plans has been falling in recent years, coverage under defined-contribution plans has been rising. Wolff (2003) finds that this shift has made the distribution of pension wealth increasingly unequal.
[17] See Behrendt (2000) for cross-country evidence on both of these points.

heavily on public pensions for income during retirement; for example, in the U.S. in 2001, more than one-fifth of workers ages 55 to 64 had no retirement savings other than social security (Weller and Wolff 2005).



Source: World Bank, World Development Indicators.

While much economic research explores effects of pensions and Social Security on labor supply, saving behavior, and fiscal balance, contributions from social economics have tended to emphasize issues of *values* in retirement-income policies. In general, public pensions have represented the kind of constructive social intervention that social economists tend to support: they have reduced material and psychological insecurities, they have advanced people's abilities to live a dignified old age, they have taken the burden off people to carry out complicated life-cycle planning, and they have reinforced ideas that pooling resources and managing them together can advance the common good. Thus, not surprisingly, social economists tend to object to the types of 'pension reforms' advocated by the World Bank and implemented in the U.K. and Chile, which aim to replace fixed-income pensions with mixed systems centered around individual accounts (Niggle 2000, 2003; Dixon and Hyde 2003; Ervik 2005). Because returns to saving into such accounts are uncertain, they recreate insecurities about living standards in old age, which have anyway been much aggravated by concerns about rising health-care costs.

Several ideas from social economics could be usefully integrated into the academic and policy discourses of public pension programs. First, while most evaluations of policy changes examine how the latter would affect people's incomes during retirement, taking into consideration that returns to saving are uncertain, they do not consider the extent to which people's well-being declines because of that uncertainty. Thus, social economists can valuably insist that measures of well-being that reflect adverse effects of insecurity be used for policy evaluation, rather than simple income measures.[18]

Second, evaluations of policy changes examine how they affect individuals or households, without taking social preferences into account -- that is, they neglect the fact that people are not only concerned with their own well-being, but also want the social context within which they live to reflect certain worthy social principles, such as preventing avoidable deteriorations in well-being, offering fair access to resources and opportunities, and extending support to people in genuine need.[19] In other words, policy evaluations need to factor in that the character of the system matters to people, not just how they fare materially within it.

Third, economic discourse about public pensions privileges the profession's knowledge highly, taking for granted that its rigorous, logical analytical frameworks provide the only valid avenue for designing pension systems that meet designated social objectives and fiscally add up. Yet a corollary of aggrandizing the strengths of economic frameworks has been a counterproductive obfuscation of weaknesses, especially concerning unresolved issues of behavioral assumptions upon which these frameworks depend. Some studies find patterns of wealth accumulation among households to be consistent with the lifecycle model of saving, suggesting that people can be expected to save for retirement just fine on their own (Hubbard, Skinner and Zeldes 1995); other studies argue that, left to their own devices, people balance consumption today against consumption in the distant future in ways that disfavor the latter, so that they benefit from pension systems in which saving is done for them (Sheffrin and Thaler 1988, Choi et al 2005). Here it is not clear that economic knowledge is being well-served by adversarial contests to determine the *one true way* to describe how people prepare themselves for retirement (or not); on the contrary, our inability to nail down this one true way suggests that strategies towards retirement may instead be plural, with some people engaging in deliberative forward-looking behavior and others using other kinds of heuristics. If we reject the old hypothesis of a unitary universal behavior as too simple, then we need to ask fundamental questions about how people acquire strategies towards consumption and saving (e.g.

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[18] Rejda and Haley (2005) provide a proposal for a broad index of economic insecurity which includes income security in old age.

[19] Bowles and Gintis (1999) discuss this point with regard to welfare form.

instruction, imitation, learning-by-doing) and about avenues by which strategies spread within populations (e.g. through family upbringing, social networks, and/or the media). The work of authors such as Boyd and Richerson (1985), Axtell and Epstein (1999), Bowles and Gintis (2004) and Bisin et al. (2004) are highly relevant here.

Finally, analyses of pensions are based on a highly naturalized view of retirement that can be fruitfully interrogated. In particular, analyses take for granted that the life-course is divided into a period dominated by work while 'young' and a period dominated by leisure while 'old'. While there are some 'natural' elements to this, as when declining physical prowess reduces abilities to do physical labor, changes in the nature of work and lengthening life expectancies have transformed retirement from a few years of relief from physical toil, into a stretch of one to three decades that people must infuse with personal meaning themselves; that doing so is not necessarily easy is suggested by the fact that depressive symptoms are much more common among older people than they are in the population as a whole.[20] A highly insightful contribution here comes from Dugger (1999) who argues that, by structuring work in a hierarchical way such that an inflow of younger workers pushes older workers "up or out", corporations create and maintain conditions under which people who are willing and able to work are induced to retire prematurely. After showing that alternative ways of organizing work could greatly attenuate the fiscal problems that public-pensions are expected to face, Dugger (1999: 84) concludes that, "If reform is really needed, what is called for is adjustment in the way work is organized, not abandonment of security for the elderly." This highlights the importance of understanding 'problems' of pension policy in terms of the broader social forces and relations from which they arise.

[20] Summarizing available research, the U.S. Surgeon General reports that 8-20% of the over-65 population has symptoms of depression; see U.S. Department of Health and Human Services (1999), Chap. 5.

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