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# RETIREMENT INCOME IN AN INFLATION ERA

(By James Hacking, assistant legal counsel, American Association of Retired Persons—National Retired Teachers Association)

Between 1970 and early 1979, the overall consumer price index rose at an average 7.1 percent yearly rate. Currently the rate is in excess of 13 percent. As harmful as inflation is to the purchasing power of the general public, it is far worse for the elderly. Price increases for necessaries have been far more rapid than those for other goods and services. The elderly, who spend much more of their limited family budgets on necessaries than the nonelderly, are in an increasing untenable situation. And the inflationary trend is building—not declining.

It is clear that inflation is the No. 1 problem that the elderly face today. In fact, the NRTA and AARP consider inflation to be such a serious concern that a contract was entered into with Data Resources, Inc., to study the effect that inflation has had on the elderly in terms of their income, assets, and expenditure patterns. Inflation's effect on the elderly is an area that is apparently not well understood. Indeed there is a "new economic wisdom" which appears to be gaining adherents that holds that the elderly fare very well in inflation times due to the implementing, expansion, and indexing of Government programs like SSI and social security. The associations are certain this "new wisdom" is wrong and intend to prove it wrong.

In order to decide how retirement income should be provided and how the current elderly generation is faring, a judgment must be made as to what constitutes an adequate income in old age. In the associations' view, adequate income should be defined as "that level of income required by an older person to maintain in his or her later years a standard of living at least equal to the highest standard achieved in his or her earlier years." A person's standard of living in his or her later years should not deteriorate if that person made reasonable arrangements for the preservation of that living standard.

A person has a variety of options when planning for retirement. The associations consider social security to be the base for retirement planning. But to that base other programs and options should contribute other income increments so that that individual can meet the "adequacy" goal. Inflation has caused complications in this planning process because it has created great areas of uncertainty about the expected contributions of the income components outside of social security and has begun to undermine the financial viability of the social security program itself.

Federal income transfer programs, such as social security and supplemental security income are indexed, so that benefits rise according to increases in the CPI. However, while progress has been made in



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putting cost-of-living escalator into these programs, much of the rest of the retirement income model has been shattered by inflation.

Most non-Federal Government components of retirement income are largely unprotected from the effects of inflation. Private pensions, as well as those of State and local retirees, fail to provide benefits that reflect increases in living expenses. Many of these plans do not even attempt to readjust benefits for retirees. Also, small savers, many of whom are retirees, are continually losing to inflation because of regulation Q, which artificially limits the small saver to interest rates which are currently less than half the rate of inflation. On the whole, the elderly are not very good at protecting their assets, especially their dollar-dominated assets, against inflation.

The older the retiree and the more remote he is from the retirement date, the greater has been the dissipation of the assets on which he expected to rely for supplementing income during retirement. Although other factors are involved, such as lower initial incomes of older cohorts, it is not surprising to note that those age 72 and over constitute the poorest of the elderly age groups. The older retiree's plight reflects a trend that is increasingly being felt by all retirees whose retirement plans are being upset by inflation. As their assets dwindle in value, the only major source for consistent retirement income has been the Federal Government's cost-indexed programs.

Increasing reliance on Government programs is a frightening trend for a number of reasons. First, social security benefits alone will be unable to meet the adequacy goal. Also, increased reliance on social security will impose serious financial strains on the system, particularly in light of economic and demographic trends, which place still further strains on Government programs.

Benefits derived from Government programs, which constitute the base of retirement income, have helped to diminish poverty rates for the elderly. However, at the same time, the inflation trend has been dissipating many other sources of a retiree's income. The result is that the elderly are increasingly concentrated in the lower reaches of the income distribution.

While the inflationary trend continues—and there are virtually no signs that this trend will be ending in the foreseeable future—several things ought to be done to help older Americans better maintain their real retirement income levels.

One source of income whose growth tends to keep pace overtime with the rate of inflation is wage income. Ready access to employment, and therefore wage income could be the best inflation hedge for the elderly. In addition, an increase in older workers has such beneficial results as greater tax revenue, decreased elderly dependency on Government programs and younger taxpayers, and more economically productive older people.

The associations have developed an outline for a national older worker strategy. The first element in this strategy is the elimination of existing employment barriers, particularly mandatory retirement policies. Paralleling the need to eliminate existing barriers to employment is the equally acute need to eliminate existing work disincentives. The major element in this category is the earnings test of social security. The associations are persuaded that the earnings test is already costing society as a whole more than it would cost the social security program to eliminate it. Elimination of the earnings test will enable productive people to remain active in the work force, and obtain relatively inflation-proof wage income.

The third element of the associations' older worker strategy is the introduction of work incentives. One such incentive for example would be the introduction of actuarially increased social security benefits for persons who elect to delay their retirement until after the age of 65. The Government might also provide for tax incentives for the employment training and retraining of older workers, and for the expansion of programs emphasizing on-the-job training of older workers.

Retirement policy in an inflationary era will be further benefited if a saving option is made viable. Specifically, the savings disincentive which is directly attributable to the artificially low rates on savings dictated by regulation Q must be dealt with. Under regulation Q, small savings accounts return less than one-half the current rate of inflation. Regulation Q ought to be eliminated; interest rates ought to be set by the marketplace.

Savings should also be encouraged through the tax code. The associations are supporting proposals which exempt a small portion of interest income on savings accounts from Federal taxation. They also suggest that an employee be allowed a deduction for funds he or she contributes to a qualified pension plan in which he or she participates, provided these contributions are used to provide some inflation protection with respect to their benefits from the point of retirement on. At this point there is no feasible and realistic legislative scheme to require employers to finance cost-of-living adjustments in private pensions that would not risk wholesale pension plan terminations.

Through the adoption of proposals such as these the effect inflation is having on retirees can be reduced. However, one must not lose sight of the problem amidst the various inflation-compensation proposals. The real problem is inflation. It is destroying the income, assets, and standards of living of the elderly and causing present workers to wonder whether there is any use to plan for retirement or even if there is any reason to save for the very next day. Inflation must be brought under control.

Because the health of the economy ought to be the chief concern, pension policy proposals—to be good—must be good economic policy as well. The proposals advanced here are designed with that idea in mind. For example, encouraging access for the older person to wage income will provide that person with a relatively inflation-proof income source. But at the same time this policy will yield tax revenue, enhance the Nation's gross national product, lessen that person's dependency on Government programs such as social security and SSI, and lessen the dependency burden that younger worker/taxpayers must bear. Another example is in the establishment of incentives for savers through tax policy and the allowance of competitive interest rates by the elimination of artificial regulatory ceilings. While such a policy would prompt people to save for their retirement, it would also provide needed capital to the economy. It would, thus, support productivity gains and thereby lessen inflation.

Of course, there are factors which are contributing to the present rate of inflation and with respect to which pension policymakers obviously have no control, such as the price of energy. However, in many ways, sound pension policy can make good economic sense. A population that is given reason to plan for its retirement can help create a more productive and inflation-free economy.