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EFFECTS OF INFLATION ON THE FINANCIAL SECURITY NEEDS OF THE WORKING AGE POPULATION

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Continued high rates of inflation will affect the needs and responses of potential customers of life insurance companies and participants and beneficiaries of non-insured employee benefit plans during their working years. This session will focus not only on the changes brought by inflation on customer needs but the potential means for adapting to new product design.

1. What factors affect the choices between consumption and saving in light of inflationary expectations, including analysis of the various forms of saving?

2. How has inflation affected the working age populations planning for future retirement needs? How should pension planning adapt to the rising price level which affects real retirement income?

3. How has inflation affected labor mobility? What are the difficulties of mid-career job changes which involve shifts away from pension credits for years of lower salaries?

4. Inflation has encouraged more working wives to supplement family incomes. How have changes in life styles and new attitudes towards family size affected the needs for insurance and annuities in financial security planning?

MR. KENNETH M. WRIGHT: The subject of inflation and financial security brings to mind many ideas and questions. For the economist in the insurance industry the subject is of particular relevance. Given the interests and areas of expertise of the other panelists, my remarks are limited to four important areas:

- First, we should understand the economic environment in which the American worker has been living and the directions in which that environment is likely to change.

- Second, we need a recognition of the significant changes in household economic activity which have already occurred because of inflation. We should be aware of how inflation affects saving decisions and the types of assets that households hold.

- Third, we should analyze the implication of the fact that workers span a diverse group. Inflation has a different impact on young, new entrants to the labor force from those who are close to retire-

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ment; the meaning of financial security is different to particular segments of the working population.

- And fourth, we need to draw some conclusions or at least present a set of questions from this analysis.

Overview of the Economic Environment

The U. S. has been plagued by economic stagflation since 1979. Technically, we are in our second recession in two years; but a case can also be made for saying that the economy has been virtually stagnant for three years. At the end of 1981, the level of economic activity was little different than it was in late 1978. Over the same period, however, the price level rose nearly 30 percent.

In a sense the word stagnation is misleading because it implies a certain calmness. But we all know that the economy has been anything but calm. Record sharp runups in interest rates have been followed by drops of similar magnitude. Treasury bill rates went from almost 16 percent to 7 percent and back to 16 percent in a period of less than a year. Sales figures for many products have also moved up and down more violently than in the past, leading to sharp reversals in production levels.

The "working population" has, on balance, lost ground in the stagflation. After taxes and adjusting for inflation, total personal income has grown only slightly faster than the U. S. population. In large part this reflects the fact that average hourly wage rates, after inflation, are lower today than they were in 1978. Indeed, in the last three years wages, in constant dollars, have fallen 8 percent.

This difficult economic period for the working population and the nation as a whole has its roots in developments that extend back more than a decade. Inflationary pressures became particularly strong in the late 1960s; early attempts to control and reduce these forces were largely unsuccessful. The lack of success can be blamed partly on external events. Oil price increases and world food supply disruptions in the mid and late seventies rocked the economy and made economic policies more difficult to formulate and to implement.

At the same time that external shocks were battering the economy, the direction of federal government spending was shifting more toward social programs. Many of the programs were, and still are, based on eligibility requirements which reduced control of overall federal government outlays. Taxes of the working population were increased, but we have been plagued by large federal government budget deficits, which strain financial markets.

This historical view provides us with some basis for evaluating the period immediately ahead. The working population and the industry must plan on continued economic volatility, especially in financial markets. While the current recession trough appears near, unemployment rates will remain high and inflation, although slowing, will persist, presenting a problem for households, business, and government officials.

Changes in Household Economic Activity

The stagflation environment has been accompanied by some fundamental changes to the economic activity of households. Three of these seem particularly germane to the insurance industry. First, inflation and less job certainty affect the saving-consumption decisions of households. Second, the inflation has altered the distribution of financial holdings of households. And third, many households have changed the sources of their income from depending on one worker to dependence on two workers.

The economic factors which affect the household choice between saving and consumption have been studied in depth. We know, for example, that in the short-run inflation may induce households to save less. If there is a general belief that prices will jump to a higher level and then stabilize, spending and borrowing will be favored over saving. This motive for spending was apparent in 1978 and early 1979 as consumers favored purchases of durable goods and homes. It should be noted, also, that in such periods many saving instruments, which depend on fixed rates of return, become unattractive.

Despite periods of lower saving, economists generally agree that high and variable inflation rates increase the proportion of income households direct to saving. There is a strong precautionary motivation as inflation generates greater uncertainty about the future value of household investments. There may also be speculative reasons for a higher saving rate. Inflation might distort relative values of some items and create temporary price bulges in some investment commodities.

Of course, the effect of inflation on saving for a particular worker depends on the age of the worker. Older workers need to divert a larger proportion of income toward saving in order to reach the standard of living they anticipated earlier. Similarly, the effect of inflation on the total pool of saving depends on the age distribution of households. We will return to these themes later.

While many factors other than inflation affect the personal saving rate, recent economic history illustrates the responses outlined above. In the period from 1960 to 1975, inflation trended upward from about a 1 percent annual rate to a 10 percent rate. The saving rate also moved upward, albeit in a highly irregular pattern. Generally speaking, after excluding the effects of other variables, a 1 percentage point increase in the inflation rate seems to add about .3 percentage point to the saving rate.

The relationship between the saving rate and inflation broke down, however, in the 1977 to 1981 period, when the rate was decidedly below trend. Inflation rates were in the 7 to 9 percent range and should have been associated with saving rates of around $7\frac{1}{2}$ to $8\frac{1}{2}$ percent. Instead the saving rate was about $5\frac{1}{2}$ percent.

Why have we had this extraordinarily low saving rate? Many of the reasons have already been mentioned. For example, there was a sizable increase in tax burdens which reduced household disposable income. Also, we experienced the buy-in-advance phenomenon in 1978 and early 1979. In addition, a higher proportion of younger workers entered the labor force in that period and younger workers typically save less of their income.

Besides altering the flow of saving, the inflationary environment has led to some striking changes in the distribution of financial assets of households. In 1959 less than a fourth of household financial assets were in bank or thrift institution deposits. But today nearly 40 percent of financial assets are in deposits, including the still relatively new money market funds. At the same time that the highly liquid deposit instruments are being favored, the proportion of corporate equities, including mutual fund shares, has fallen sharply.

Of particular interest is the share of household assets held as life insurance and pension fund reserves. Combined, these two assets have trended up as a share of total. However, all the growth has been in the pension area. Life insurance reserves are now about 5 percent of total financial assets compared with 7 percent in 1969 and 9 percent in 1959.

The third noteworthy alteration in the household economic situation has been the increase in the number of two-income households. There seem to be many noneconomic factors which bear on this fundamental change in our society. But the inflation and stagnation of recent years have certainly contributed to the number of multiple wage earner households. In 1959 the percent of working-age women in the labor force was 37; today that figure is 52 percent. Perhaps more striking, however, is the rise in the proportion of husband-wife households where both husband and wife are in the labor force. Today half of all husband-wife households are in the labor force; in 1959 it was around 30 percent.

The Variety of Adjustments

So far the implication of inflation for the financial security of the working population has been addressed from a very broad economic perspective. Actually individual adjustments have been and will continue to be very diverse, suggesting that a variety of needs could be met by the industry. One obvious characteristic of the worker which should be considered is age.

Consider first the older worker with some financial assets. That worker's needs are immediate because his assets may have lost much of their purchasing power. How does this person solve his retirement income problem so that his holdings will restore some of the lost purchasing power and, if possible, protect him from future losses?

Another consideration is that older workers near retirement may be holding assets which have increased in value with inflation but are not very liquid. A home is the most common type of physical asset held by this group. There needs to be a means for switching the illiquid asset to one that will produce income but still retain its value.

At the other end of the age spectrum is the younger worker. Here the inflationary environment dictates a need for diversification of investments due to the added uncertainty of future values of any one asset. More planning is required and professional investment counselling is a possibility. However, it should be noted that this group can take more risks than the older group.

The larger group of middle-aged workers faces a third set of problems. The stagflation environment has led to more job insecurity. Today, reports indicate that a higher value is being put on seniority, the maintenance of pension privileges, and other income security issues. Furthermore, job mobility has been reduced as location changes must consider the spouse's career and status, as well as the difficulties presented by high nominal mortgage interest rates or other moving problems. Still, the number of years before retirement for this group allows for many financial options.

Some Implications and Questions for the Industry

The above analysis leads to a number of implications. For example:

- The economic environment of workers is much more complex and uncertain than it was before inflation took hold in the late sixties. This situation produces demands for more planning and the need for individuals to seek professional financial advice.

- Also, households are already holding a large proportion of their financial assets in highly liquid forms. These assets provide for unusual opportunities for switching into other investment vehicles should inflation be reduced significantly in the near future.

- The unusually low saving rates in recent years have led to changes in laws aimed at reducing tax burdens and increasing personal saving. A one percentage point difference in the personal saving rate represents over $20 billion a year -- a sizable flow of funds for financial institutions to invest.

In addition to these implications there are numerous questions that need to be analyzed further. A few are:

- Do pensions need to be designed with more portability in order to satisfy job mobility problems?

- Do two wage earner households need more life insurance or less? An argument can be made for either situation.

- More specifically, do existing insurance and pension products meet the needs of the two wage earner household?

- Is diversity of products adequate for the inflation environment and the mix of workers in the population?

MR. MATHEW GREENWALD: The inflation this nation has suffered over the past decade has done much more to American families than reduce the purchasing power of their dollars. It has reshaped their deepest hopes and fears, helped drive women, especially mothers, into the labor force, contributed to a changed relationship between parents and children, and decreased feelings of personal control over life. Many of these factors bear on the financial security needs of families. I would like to first discuss the impact of inflation on family lifestyles and then deal with the subject of implications for financial security products.

My first assertion was that inflation reshaped deepest hopes and fears. My evidence for that comes from nationwide surveys conducted by the Gallup Organization (in 1959, 1964, 1971, 1974 and 1981). Each of these polls asked respondents four common questions: 1) what are their most important hopes for themselves; 2) what are their major concerns and fears for the future; 3) what are their hopes for the future of the United States; and 4) what are their fears for the future of the country.

Let's start with fears for the nation. In 1959, the predominant fear was war. Sixty-four percent mentioned this compared to the second most mentioned item, economic instability which was cited by 18%. By 1981 fear of economic instability almost doubled -- it was mentioned by 33% of respondents, while war was mentioned by 41% -- a 23 percentage point decline. Fear of unemployment doubled in this 1959-1981 period.

What about hopes for the nation? Peace was the main hope in 1959. Just about half of the public mentioned it. Hope for economic stability and no inflation was mentioned by just 12%, and that dropped to 5% in 1964. But after 1964 the hope for economic stability rose in the minds of Americans. Eighteen percent mentioned it in 1971, 24% in 1974 and 37% in 1981. Last year for the first time in five surveys peace was not the number one hope of the United States. It was displaced by the hope for economic stability.

Next I will turn to the personal fears of the public. Back in 1959 the predominant fear was ill-health. Forty percent mentioned their fear of becoming sick, 25% mentioned fear of ill-health in the family. Coming in third was a fear of a lower standard of living (23%), mentioned by a similar 18% in 1971 and 16% in 1974. But in 1981 this fear topped the list. Thirty-two percent mentioned it, compared to the 18% who worried about becoming sick and the 16% who worried about war.

In most years the most mentioned personal hope of Americans was a better, or decent, standard of living -- including 1981 when 30% mentioned it. Not too much change here. But there have been other significant and revealing trends in the area of hopes that I will refer to later.

My primary point thus far has been that the economic conditions of the past decade have had an impact on the deepest concerns of Americans. Long-standing and basic concerns about health, war and peace have been displaced by economic worries.

How has the family been affected? I believe the impact has been great. We must start with the move toward dual income families. The growing labor force participation of women is common knowledge. It started before the current inflation. Surely rising educational levels, the growth of the services sector of the economy and the women's liberation movement have played major roles.

To focus more closely on the specific impact of inflation of women's work decisions we should look at a specific type of family -- those with husband and wife together and with young children. The results of this "look" are dramatic and disconcerting. The rise in the labor force participation of mothers with husbands present and children under age 6 has been far faster than for women in general. As you know, labor force participation rates of wives, as a close example, went from 31% in 1960 to 50% in 1980, a rise of 66%. For wives with children under age 18 the increase was from 28% to 54%, a rise of 92%. But for wives with at least one child under age six, the labor force participation rate was 19% in 1960 and a full 45% in 1980. In other words labor force participation rates of married women with at least one pre-school child increased by an astounding 135%. Now almost half the mothers of pre-schoolers work or are seeking work! And this will surely rise in the near future.

To fully understand the importance of these patterns the cultural resistance to mothers being out of the home must be recognized. Let me refer to a 1978 nationwide survey conducted for the American Council of Life Insurance by the firm of Yankelovich, Skelly and White. When asked if they agree or disagree with the statement, "If a woman has children, she shouldn't go to work until they are grown, unless it's an economic necessity" only one-quarter of respondents could disagree. Also in that survey, respondents were asked how important it was for a woman to have each of 17 qualities. The one that was mentioned as very important more than any other -- even more important than

At this point a comment on fertility rates seems in order. As recently as 1957 there were approximately 120 births per 1000 women ages 15-44. After that the fertility rate dropped steeply and fairly consistently until it was barely over 60 (half the 1957 level) in 1976. Since then there has been a very slight rise. The number of births will go up because of the sheer numbers of women of child bearing age, but there seems little likelihood of a rise in fertility rates through the 1980s. The reasons -- economic pressures and a growing attachment of women to work. The experts disagree about what fertility rates are likely to be in the 1990s. Dr. Charles Westoff, Director of the Office of Population Research at Princeton University stated simply (in the March 4, 1982 Wall Street Journal) that "fertility is going to remain low because there are no forces in sight that are going to turn it around." On the other side, Dr. Richard Easterlin, Professor of Economics at the University of Pennsylvania argued in his recent book Birth and Fortune that there will be a relative prosperity in the 1990s and less inflation, better job security and lower mortgage rates facing young families. This will lead, he concludes, to higher levels of fertility. Of crucial importance here is the agreement that both demographers with the role economic difficulties and labor force participation have played in reducing fertility.

In 1968, 1973, 1975 and 1978 the American Council of Life Insurance surveyed the American public on their feelings of control over key aspects of life. As you probably guessed the sense of control people feel declined strongly over the 10 year period. The data obtained clearly indicates that inflation was a major reason for the decline. The decline in control was greatest for tasks that were to be accomplished over time. For example, in 1968, 58% of the public felt a great deal of control over accumulating funds for retirement. By 1978, it was 38%, a 20 percentage point decline. The sense of control over providing for children's education declined 19 percentage points in this period. For the more immediate task of purchasing services and products at reasonable prices, feelings of control actually went up. This probably reflects the public's greater attention to shopping and obtaining product information.

A loss of personal control has been associated with a variety of negative consequences, including ill-health and early mortality. It has also been associated with societal vulnerability to fascism and social unrest. Clearly it is a subject to be taken seriously.

It is very difficult to really understand the impact of lowered feelings of control on American families during the 1970s, but I will try to make some assertions, which will be based partly on research and largely on interpretation and intuition.

In the early and middle 1970s as economic instability and inflation lowered feelings of control there appeared to be a turning to government to accomplish what individuals felt less able to do for themselves. The psychology of entitlement -- the turning of a "want" into a "demand" -- was, I believe, fueled by a loss of control. By the late 1970s, with the nation's continued inability to address inflation, distrust of government went up. People's hope that they could rely on government for financial security in retirement and other key needs suffered. The psychology of entitlement eroded. Now I sense an increased desire for self-reliance, a stronger need to regain control over life. This seems to be expressed in various ways such as the push for more local, as opposed to federal control and the increased interest in home repairs and self-health care. The emphasis of the Reagan Administration on self-reliance has certainly contributed to the importance the public places on it.

being a good parent, being loving, maintaining self-respect and putting her family before anything else -- was spending time with her children. These survey results indicate to me the extreme pressure mothers face when they consider working.

One more point about working mothers based on the surveys of hopes and fears of the population. In 1959, the third most often mentioned hope of the population was an aspiration for their children -- 29% mentioned one. By 1964, 35% mentioned one, making it second on the list. As late as 1974 aspirations for children were mentioned as a personal hope by a full 24% of the sample. Yet in 1981 only 8% cited an aspiration for their children; six items were more frequently mentioned. What happened? William Watts, principal analyzer of the survey wrote (in the September 1981 issue of Psychology Today), "None of this implies that parents have stopped caring, stopped loving their children... other studies have repeatedly revealed the importance of family life to adult participants. The issue is not lack of love but a new relationship." The new relationship Watts refers to is one in which parents have far less control over their children's lives. Watts says that those who feel they cannot influence the outcome of their children's decisions have become resigned to that fact. With the rapid rise of mothers working, it should not be surprising that feelings of parental control have diminished. Mothers who work must have less time to spend with their children.

Working mothers and working women also have less time to spend doing the panoply of chores that were, in an earlier era, referred to as "women's work". This has led to a massive growth in convenience industries, including fast food restaurants. It has led to a major reorganization of household duties in many families. At one time it was fairly easy to predict who in a family took out the garbage and who cooked dinner. Those predictions have become less accurate. It has become more difficult for corporations to relocate executives, because today's executives are more likely than yesterday's to have working spouses who cannot easily change jobs. In sum, the movement of women into the labor force has created far reaching economic and social change, and a changed relationship between parents and children is only one small aspect of this.

There is one oft-overlooked point about family income that should be brought up as we consider the financial pressure on women to work. During the decade of the 1970s, from 1969 to 1979 to be specific, median family income went up by only 5%, from $18,700 in constant 1979 dollars to $19,700. But there were a number of factors that impacted on that. One example is the large growth in single parent families. For "married couple families" the increase in family income was almost double the average for all families. In constant 1979 dollars the median family income was up 9%, from $19,800 in 1969 to $21,500 in 1979. Another factor is even more important, the declining size of households. Considering average income per family member in real dollars -- a better measure of relative affluence -- we can see an 18% increase from 1969 to 1979, from $5,800 to $6,800. Even those figures do not take into account the tendency toward lower incomes created by the entrance of tremendous numbers of young baby boomers and women into the labor force.

As has been pointed out the principal American hope is for a better standard of living. This was achieved during the inflation and economic instability of the 1970s, in large part, by the increasing willingness of women (and especially mothers) to work. Additionally, the pressures of economic uncertainty have been credited with playing a role in depressing fertility rates.

Two findings from Council research touch on this issue. Earilier I mentioned our study of qualities that the public felt were important for women to have. The Council also surveyed the public, in 1968 and 1978, on qualities it felt were important for a man to have. Of the 13 qualities tested in both 1968 and 1978, 12 qualities declined in importance. The declines were especially large amoung what might be termed "macho" area -- such as being physically strong, keeping feelings under control, willing to risk his life in the face of danger. Which one, out of 13 qualities was deemed of increasing importance? It was being able to make home repairs.

Very recently, the Council conducted five group interviews in various regions of the country on the issue of Social Security. While the people participating in the group interviews all felt the Social Security system was very important, most of them also expressed a renewed desire to take more responsibility for their retirement security and to be and feel less dependent on a government system.

Let me summarize what I have said thus far and then talk about what impact changed family lifestyles have for financial security products. The deepest hopes and fears of Americans have changed over the last decade, largely, in my opinion, due to inflation. Inflation and economic security have driven millions of women, and especially mothers into the work force, which has in turn weakened the relationship of parents and children and caused major additional changes in family roles and support institutions. Finally, inflation has contributed to a declining sense of control over life, which appears to be leading, very recently, to a renewed premium on self-reliance.

Now, to the extent that what I have asserted is true, what impact will it have on financial security products?

During the past decade, as I have implied, women accounted for 60% of the growth of the labor force. The changing composition of the labor force will accelerate pressures on fringe benefits and work flexibility that have already been felt. The emphasis, if there really is a new emphasis on self-reliance and it continues, could be on flexible work plans. The popularity of cafeteria fringe benefits should grow. The demand for employed sponsored child care should grow, and the demand for flex-time, work-sharing and other systems that permit working mothers and fathers to more closely supervise their children should grow. It has recently been estimated that two million elementary school children are what have been called "latchkey" children. Newsweek reported that a number of schools now give courses in domestic survival to children of working mothers.

Cafeteria benefits are, of course, more expensive due to adverse selection. But if the move toward self-reliance continues workers might very well accept lower levels of benefits and more responsibility if the types of benefits they do receive are more appropriate to their needs.

There are two contradictory trends that impact on product design. On the one hand the lowered sense of personal control, the growing complexity of financial products and the volatility of the economic situation point to the growing public need for financial advisors and counselors. Indeed, Council research noted a recent increase in public appreciation of life insurance agents. This line of reasoning suggests that people do not want financial products that they must manipulate themselves, because they do not feel they have the expertise to make those decisions. On the other hand if there is a growing sense of self-reliance then products which allow people to select, or change investment vehicles, or adjust mixes of whole life and term, for example, could be very attractive. I suspect that generalities are difficult here, and that different products are appropriate in different market segments.

The changing parental-child relationship has implications for financial products. When life spans were shorter and parental-child linkages were closer, parents were more likely to feel financial obligations to their children over their whole life. Now, the obligation is a good deal shorter, and I suspect that the value placed on financially helping grown children and grandchildren or leaving an estate has gone down and will continue to decrease. Therefore the value of annuity products which are exhausted on the death of the surviving spouse become more attractive. For example, over the next decade or so, especially if interest rates come down, I see an important growth of interest in reverse annuity mortgages. Other financial products which become exhausted on the death of the surviving spouse will be more attractive.

Finally, the inflation of the last decade appears to have shortened time perspectives and places more of a premium on products which are quickly responsive to changed economic situations. Perhaps the main point about the recent inflation is that it has left a mark on the American family that, if it is not indelible, will at least take quite some time to erase. It is clear that times have changed. The difficulty is in designing products for needs that have just emerged or are still emerging.

MRS. ANNA M. RAPPAPORT: The U.S. economy is the major story in the domestic news today. It is a concern to everyone; a major concern to the government, to employers and to individuals. This paper will focus on economic conditions and issues facing employers in trying to meet employee needs for financial security in a productive way; given that the economy is chaotic and that today's environment is dramatically different from that under which the benefit and compensation programs in place today were originally developed.

The story is an ambiguous one. For example, the International Foundation of Employee Benefit Plans sponsors a national opinion panel. Its results for the third quarter of 1981 included a question: "Do you believe the Reagan budget cuts will help curb inflation?." 75% said yes. The panel responded to another question: "Will there be a reversal in the U.S. automobile slump before the end of the year?." 70% said no. Together, these two questions show some optimism and some pessimism. If we look at the Wall Street Journal on any given day, we also are likely to be able to find stories which show some optimism and others which show some pessimism. This reflects the feelings of most Americans. They are hopeful that the things that are being done will work but are not willing to bet that they will. This can be viewed as a good news, bad news story. The bad news is that there are a lot of problems; the stock market is not doing very well and inflation has moderated somewhat but it persists. The good news is that the government is working very hard to take action. Companies can respond and the regulatory climate is better. Economic signals point out the need for employer and government action. Government has started a massive program. Some of the questions we need to ask today are: Will the solution work? What can each of us as individuals do to create solutions that will work well for our organizations?

The objectives of this paper are: 1) to identify key trends which are important in understanding the economy, 2) to describe the response undertaken by government, employers and individuals in meeting some of the challenges today, 3) to define traditional and future security needs of employees, and, 4) to provide employers and actuaries with some areas for further study.

Key Trends

Trends discussed will include economic trends, values and changes in the work place, since employers should respond to these trends in an integrated way.

Median family income on an after tax basis in 1970 dollars has changed little in recent times. In 1970, median after tax family income was $8,528. Table I shows median family income in 1970 and current dollars from 1970 to 1981. By 1981, the equivalent amount adjusted to 1970 dollars was only $9,184. While the amounts are relatively flat, there have been years of increase and years of decrease. Table I also shows family income in current dollars. Median family income before taxes and without adjustment to reflect the decline in the value of the dollar increased from $9,867 in 1970 to $24,035 in 1981. However, the amount needed to pay federal income and Social Security taxes increased from $1,339 to $4,449. The amount needed to cover inflation since 1970 was $10,357, leaving after federal tax family income in 1970 dollars almost unchanged over the entire period. This happened even though many families added a second wage earner during this period.

The next trend is debt outstanding, which has increased significantly. Debt outstanding reflects the extent to which society has borrowed, and created an obligation to be paid from future earnings. Total debt outstanding in the U.S. was well under $100 billion in 1960; by 1970, it had risen to over $100 billion and by 1978 to well over $400 billion. Debt then dropped a little by 1980. Growth in government, business, and personal debt is viewed as a major contributor to inflation; control of borrowing is important in the resolution of economic problems.

The next area in the data is productivity. The average increase in output per hour was over 3% in 1959-66, dropped to a little over 2% in 1966-73, and then down to nearly 0 in 1973-80. Productivity is a major issue for employers and for our country. At the same time that productivity growth plummeted, real growth has dropped from over 4% a year growth in gross national product to a little over 3% to a little over 2%.

The next trend area is transfer payments. Transfer payments are amounts which the government collects from a group of citizens in the form of taxes and pays to other citizens in the form of Social Security payments, food stamps, public welfare and other government payments. Data from the 1982 budget of the U.S. government in constant 1982 dollars shows that defense spending has been relatively stable since the early 1950's as has net interest and other non-defense spending. On the other hand, payments for individuals and grants, i.e., transfer payments, have grown at a rapid rate during that period. Transfer payments include many of the items which the current budget cuts will be seeking to reduce. Feldstein and other economists believe that growth in transfer payments has served as a significant drag on the economy and contributed to U.S. inflation.

Family income, the first trend area, reflects income earned by all earners and it also reflects the transfer payments which might be paid as social security and other items. Therefore, the real earnings picture of individuals is even less favorable than the family income picture. The labor force participation rate of married females with husbands present adds another dimension to this picture, because it indicates the number of families for which family income is a result of two or more people working. In 1950, 22% of the females living in families with husband present were working. This 22% increased to 41% in 1970, and to 50% by 1979. The majority of families with earnings of over $25,000 depend on at least two incomes.

Another economic trend of concern is medical care cost increases. Medical care costs are increasing faster than the CPI. This is due to many factors including inflation, improved technology which provides for more complicated and expensive methods of treatment, greater utilization of medical care facilities and increased access to medical care facilities which in part is a result of entitlement. These statistics provide some useful insight. The hospital cost per patient day was $133.77 in 1975. It increased 69% to $226.46 in the four years from 1975 to 1979. Hospital admissions per 1,000 population increased from 158 to 167 over that four-year period and surgical operations per 1,000 population increased from 79 to 85. This data illustrates the combined effect of increases in cost for a service and the effect of more service being required.

These trends interact to hurt the employer and individual employees. Many employees are members of families which include more earners. That creates other strains for the family, which must still maintain a household, care for children, etc. In spite of the increase in earners per family, there is little growth in real disposable income per family. For many years after World War II, the expectations of Americans were for more growth, more prosperity and more of everything. However, during the last few years, many Americans have experienced a reversal in their expectations.

In order to interpret and deal with these economic issues, the manager needs to look at values. Daniel Yankelovich has written a comprehensive review of the changing values of Americans and he says, "that Americans are searching for self-fulfillment in a world turned upside-down". He states that 80% of Americans are involved in the search for self-fulfillment. He states in New Rules:

> "Many observers have concluded from the news coverage of the past year--the Reagan sweep, the disarray of political liberalism, the tighter constraints of our economy, the emergence of fundamentalists groups opposed to the ERA abortion and sex eduction--that the U.S. is swinging back to the disciplined, self-sacrificing habits that ruled American life before the heyday of American affluence. But that inference is incorrect. Tomorrow is not going to look like yesterday. In fact, tomorrow--to the extent that research data can yield clues about it--is being shaped by a cultural revolution that is transforming the rules of American life and moving us into wholly uncharted territory, not back to lifestyles of the past."
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> (Quoted from Psychology Today,"New Rules in American Life: Searching for Self-Fulfillment in a World Turned Upside Down." April, 1981, p. 35-36.)

These value shifts are important to employers because they affect the behavior of employees in and out of the work place. Essentially, Yankelovich states that a shift is taking place in our culture and in our economy. The data we presented on the economy provided evidence that the economy has in fact grown more restrictive and that past expectations of ever increasing affluence are no longer realistic. At the same time, the culture has expanded, so that members of our population who are involved in the search for self-fulfillment have new options, including some which might not have been considered possible in years past.

The following data from public opinion surveys provides evidence of the major changes in norms governing American life which is presented by Yankelovich. The first issue is: How many of the public disapprove of a married woman earning money if she has a husband capable of supporting her? In 1938, 75% disapproved. By 1978, that 75% had dropped by 26%. The second issue is: Do you agree that hard work always pays off? In 1969, 58% agreed. The 58% had dropped to 43% by 1976. Do you agree that work is at the center of my life? In 1970, 34% agreed. By 1978, the 34% had dropped to only 13%. This data shows a decline in attitudes toward the importance of work which, in turn, contributes to productivity decreases. The last issue chosen as representative is: Do you agree that people can trust the government in Washington to do what is right? In 1958, 56% agreed. By 1978, only 29% agreed. This shift is generally representative of the decline in the trust of institutions in U.S. society.

These shifts in values affect our employees. They indicate that employers can't deal with current issues by simply returning to the past. They are confirmed by individual behavior. For example, many more people have been divorced in recent years. In 1951, there were just under 450,000 divorces. This increased to well over 1 million annually by the 1975-1977 period. Career switching has become more acceptable today and affects the workplace. The decline in the work ethic affects all employers. Economic expectations no longer include infinite growth, but still include entitlement to a significant degree are found in a new search for job security. Employees expect the government and employers to make them financially secure.

To the economic and value trends should be added perspectives on the workplace. Business Week (May 11, 1981) defines what they call the new industrial relations in an article entitled, "The New Industrial Relations." They state:

> "Quietly, almost without notice, a new industrial relations system with a fundamentally different way of managing people is taking place in the U.S. Its goal is to end the adversarial relationship that has grown between management and labor and that now threatens the competitiveness of many industries... A more enlightened view of work psychology has taken hold today. It stresses that most people want to be productive and will--given the proper incentives and the climate of labor management trust--eagerly involve themselves in their jobs... Many companies, some in collaboration with once-hostile unions, are creating new mechanisms to gain worker involvement."

The new industrial relations is important to employers in understanding our workplace and in defining compensation patterns for the future. Worker rights are something that have been defined and accepted over the decades just past. Today, the focus is shifting away from further expansion of worker rights and from an adversary relationship to a cooperative effort to meet common goals. Why? Because workers and employers alike are being hurt by productivity problems. Some 40% of the American workers, according to Yankelovich, are new value workers who share, in some degree or another, non-traditional values. They want their jobs to be interesting as well as to pay well. This factor has significant implications for the organization of our workplaces. The quality circle is a method of implementing participation which is being tried increasingly today.

Changing family composition is also changing the workplace. Employees today have several family situations. The American work force today includes 20% who are traditional family heads, 45% who are either husband or wife in a two earner family, 25% who are single and 10% who are single with dependents.

To summarize, the environment includes a number of trends which together raise issues for compensation management. Inflation has been a persistent problem for employer and employees alike. Poor productivity increases have gone hand in hand with inflation and flat real income. Average family income has been flat even though more members of the family are working. The work force mix has changed, with more females in the work force and more two-income families. About 80% of the population is involved in some sort of search for self-fulfillment. The relationships between employer and employee are changing, with employers searching for ways to create a spirit of partnership.

These issues challenge compensation management and the actuaries developing programs for them to develop innovative programs. A summary of these issues can be recast as follows: The employer's bottom line issue is profit, which depends on productivity and cost control, which depends on using compensation dollars effectively.

Response to Trends

How has U.S. society responded to the challenges posed by these trends? Response will be reviewed by looking at government, business and family. Government has embarked on a very dramatic program. Underlying this program is the election of Mr. Reagan and of many Republicans to the U.S. Congress. The Reagan administration has profoundly different economic philosophies than the administrations that have preceded it in the past few years. It has been very aggressive in developing a program to implement those philosophies. One of the first steps of the Reagan administration was the passage of ERTA - The Economic Recovery Tax Act of 1981. ERTA includes incentives for productivity, for savings and for capital investment. Its thrust is entirely different from that of previous tax legislation. It is one of several steps that tries to reduce the government's role rather than expanding it. Tight money is another major tool of the Reagan policy. The purpose of tight money is control of the growth in the money supply and inflation. Major budget cuts including decreases in transfer payments are another piece of the program.

Response to economic issues can be viewed as the major thrust of government today. Business has also responded to current economic issues. That response is a first priority for many managements. Business response includes attempts to involve workers differently in their jobs and to encourage worker participation in decision making in order to improve productivity. Cash management is important for virtually all businesses as is control of expenses and expense management. Many companies have been partners in mergers in order to become part of more effective total business. Some businesses have suffered declines and have been forced to lay off workers. Others, including airlines, have reduced pay and/or work schedules to avoid layoffs. There have been changes in management teams. Some of the changes in management have been accompanied by special early retirement programs. These programs encourage long-service employees, including middle managers, to retire early, to reduce payroll and make room for advancement of younger people and to provide for reduction in the total management ranks. Sears and Montgomery Ward are two Chicago area companies which have implemented such programs.

Many corporations are implementing programs both to contain health care costs and also to encourage employee health. Such programs can include many specific activities such as finding the most effective plan financing, benefit redesign, encouraging the efficient pattern of care, use of review before hospital admission, extensive data collection and analysis, and second opinions on surgery. In retirement plan management, plan sponsors and their actuaries are reviewing the actuarial basis for funding their pension plans. In many cases, actuarial assumptions and/or funding methods are being changed to slow down somewhat the funding of these benefits.

Individuals and families are also responding to inflation. This concern is reflected in a new focus on job security, on changes in the numbers of families with multiple earners, and in changing spending patterns. Job security has become a major new issue for many individuals and it can be expected to be a concern reflected in upcoming bargaining. News reports indicated that job security will be a focus of major unions in response to this change in the concerns of individuals. Individuals and families have responded to inflation by more wives entering the labor force, and by a spending pattern which incorporates the second earner's income as an intergral part of what the family needs. Therefore, many second earners no longer have a choice about continuing work.

Families have also controlled individual spending and shifted their spending decisions. For example, Americans are buying smaller cars today. There are fewer two-car families. Americans are slower to replace cars, appliances and almost everything else. Generic no-frills groceries have emerged in the market. For many years the single family-owned house was viewed as the birthright of all Americans and an integral part of the "American Dream." Today, multi-family housing has become far more common, and home or condominium ownership is increasingly diffiuclt for more Americans. For many families, home ownership is the factor which locks the second earner into the labor force.

These changes add up to significant issues for business. Business must manage dollars paid to employees in order to get the maximum value out of those dollars. Key to such management is an understanding that compensation and productivity are related. The company or organization concerned about productivity must focus on a number of areas including compensation and benefits. A 1980 Mercer survey, "Employer Attitudes Toward Compensation and Employee Productivity" showed that 98% of the respondents say, "a well structured compensation program helps with productivity." The survey report indicated that "employers are also convinced that well structured compensation programs can help increase the rate of productivity. They also believe that the primary purposes of compensation plans are to recognize superior performance and to enable the company to compete in the market place. At present, though, only a slim majority believe that their compensation plans are satisfactorily designed to reward the most productive employees." This indicates that compensation is important, and that today, compensation is not doing the job it must do in the long term.

Workplace organization is also very important. 79% of the Mercer survey respondents say that participation by the employees is important in improving productivity. 92% say that communication of expectations is important. The study also documents that employee communication in general is very important. Compensation and workplace organization are complimentary in coping with these economic issues. Some employers have been doing a very good job and little change will be needed from what they are doing now. Planning will help them continue along the well-reasoned course that they undertook long ago. In contrast, other employers have been muddling through, and they will find that the programs in place today are not working satisfactorily now and will not work in the environment of the 1980's. For them, careful planning and an analysis of the environment is a must, as is a willingness to reconsider the ideas that they have always been held to be true. Success, and perhaps even survival, will depend on willingness to do new and different things.

Traditional and Future Security Needs

The security systems in place in the U.S. today are grounded not in the economic climate of the 1980's but rather on a base of a more secure economic environment and stable family climate.

The material on economic trends has pointed to the economic environment and focused particularly on the major issue from the viewpoint of the employee: no growth in inflation-adjusted family income. Security system response to these issues has to consider the other environmental factors affecting the employee, and Chart I summarizes the traditional and new environment for employee security.

The most significant element in making a long-term security system work is stability of the institutions on which it is based. In current terms, this means stability of the dollar and stability of the employer of government unit providing the benefit. There is nothing that security system designers can do to avoid these fundamental underlying principles.

The United States has moved to a situation where there is less stability in the underlying dollar values and in the institutions which provide security. As a result of the current environment and technology, the security needs of individuals have become more complex. Chart II summarizes the employee security needs under traditional situation and the current situation. The major shifts are as follows:

1. Value needs to be maintained in already purchased benefits.

2. Lifelong education has become a major security issue, since continued employability cannot be taken for granted.

3. Job security has moved from being taken basically for granted to a major concern for many Americans.

4. Income after a divorce is a problem for many.

The solutions to the issues raised are complex and confusing, and will vary from employer to employer. Productivity must be a key concern in the development of programs for each employer.

The issues for actuaries and benefit management in the 1980's will include:

1. Maintaining value of income replacement benefits
2. Finding tools to sort out complex issues/priorities
   - Strategic planning approach holds the key
3. Response to diversity of the family
   - Individual choices through more contributory plans and/or trade-offs
   - At simple level, allow trade-off for dependent medical care
   - Day care involvement by employers
4. Job security as an employee concern
5. Building employer/employee partnership to meet common goals
6. Meaningful lifelong education - Encouraging and financing such education
7. Assisting employees with home ownership
8. Assisting employees to get through the problems of divorce
9. Implementing new work options, and offering a greater variety of work options
10. Gradually reversing trend to early retirement, making gradual retirement possible through new work options

CHART I

Environment for Employee Security

Traditional Post World War II Expectations = American Dream	Reality of 1980's = Diversity of Lifestyle/Individual Choice
Stable dollar	Inflation
Linear Life Cycle	Cyclical Life Cycle
Education - Usually completed by age 25; viewed as a prework period activity	Education - Lifelong
Family - Traditional Breadwinner - Husband Homemaker wife, 2-3 children, long-term stability	Family - Diverse Mix of traditional 2-income family, single with dependents, shifting over life
Family Stability - Lifelong marriage expected	Divorce rates high, and shifts accepted
Children - 2-3 norm per family	Very low birth rates
Continually rising income in real dollars	Flat income in real dollars, decreasing on after-tax basis for many
Home ownership expectation of most Americans	Home ownership difficult for many; shift to multi-family housing
Cheap unlimited energy	Expensive energy
Retirement at ages 60-65	Retirement future unclear
Good employer = Job security	Much less job security as all employers become cost conscious, more mergers, business failures, etc.
Good work ethic; upward mobility based on merit	Search for self-fulfillment; less work ethic
Rising productivity	Flat productivity
Trust in institutions	Lack of trust in institutions
Sex based job distinctions on a de-facto basis	Eroding of sex based job distinctions - emergence of employee rights
Employer control of worker place	Search for new employer/worker partnership
High technology medical care viewed as solution to health problems	Search for solution to health problems

CHART II

EMPLOYEE SECURITY NEEDS

Traditional

Job security (somewhat taken for granted)

Unexpected high medical care expenses

Income replacement due to:
- Death of income provider
- Disability
- Retirement
- Unemployment

New

Job security

Unexpected high medical care expenses

Income replacement due to:
- Death of income provider
- Disability
- Retirement
- Unemployment

Child Care

Education to maintain employability

Find means to achieve home ownership

Self-fulfillment

Maintain already achieved living standards

TABLE I

Effect of Inflation and Taxes on Median Spendable Family Income 1970-1981

	1970	1972	1974	1976	1978	1980	1981
Median Family Income	9,867	11,116	12,902	14,958	17,640	21,850	24,035
Federal Income and Social Security Taxes	1,339	1,469	2,031	2,289	2,952	3,765	4,494
Amount Needed to Cover Inflation since 1970	n/a	724	2,225	3,764	5,576	8,639	10,357
Net Spendable Income in 1970 Dollars	8,528	8,923	8,646	8,905	9,112	9,246	9,184

Source: Conference Board, Economic Road Maps, April 1981

TABLE II

Income Needed in Various Years for Equivalent Spendable Income

	Pretax Income In		
	1975	1980	1981
5,000	6,620	9,607	10,856
10,000	13,924	20,097	22,477
25,000	34,705	52,244	59,012
50,000	70,592	106,282	119,098

Source: Conference Board, Economic Road Maps, April 1981