

Averting a Bust for the Boomers
Remarks on McKinsey Global Institute Study,

The Economic Impact of Aging U.S. Baby Boomers

Capitol Building, Washington, D.C.

June 5th, 2008

By Phillip Longman

Next Social Contract Project, New America Foundation

Why are so many baby boomers ill prepared for retirement?

The short answer provided by this report is, essentially this:

That baby boomers earned more at every age than any other generation in history... and blew it all away by saving next to nothing.

I commend this report for the warning it provides. If we don't get on top of the trends it describes, the elderly of the next two decades will be by far the fastest growing poverty group in America.

But I also want to point out how the report, on a casual reading anyway, reinforces a negative and distorted stereotype of the baby boomers as spendthrift yuppies. Here I have to take exception, both because the stereotype is inaccurate, and because it obscures the real lessons we must learn from the fate of most boomers in old age.

When I first picked up the report I saw the chart on the boomers earning history compared to that of other generations. Something looked wrong to me. The numbers for the boomers just looked too large. Could it really be that a typical household headed by a person in their 50s has disposable income of over \$85,000 dollars? I know plenty of once young, now middle-aged urban professionals (muppies?) here in Washington who do a lot better than that. But across the country as a whole, including the majority of boomers who never completed college? I didn't think so.

So I quickly hopped over to the Census Bureau's [Current Population Survey](#). And sure enough, it shows *average* household income numbers for that cohort in the range of \$85,000.

But then I noticed something striking. The *medium* income numbers were much, much lower. For example, in 2006, according the Census Bureau, households headed by a person 45-54 had an average income \$85,812. But the medium income of such households was some \$20,000 less. The difference between average and medium works out to about 25 percent.

What does that tell you? It tells you that in thinking and speaking about the boomers, beware the mean and all the yuppie stereotypes that are fueled by it. Income inequality, let alone wealth inequality, in this generation is extremely high. Its average income includes the earnings of Bill Gates and countless other baby boom billionaires, plus a very large new class of McMansion-owning minor millionaires.

Because of very high income inequality within the baby boom generation, medium income statistics tell us a much more accurate story than do average income stats about how the “typical” baby boomer lives.

According to the Census bureau, roughly one-in-five have household income below \$30,000. Half must get by on less than \$65,000, even though they typically have two paychecks. Stagnant wages and downward mobility have been the story for the vast majority of baby boomers, most of whom have working-class jobs.

Do you want to see the face of the prototypical baby boomers? He doesn't drive a hybrid or a Land Rover, and he'd quit his job right now if he could; she has a job, but it's as a waitress, a nurse, a school teacher. Think of the demographic that went overwhelming for Hilary Clinton in the late primaries and eventually gave her the popular vote. In that demographic, it's not uncommon at all for people to be earning less than their parents did at similar stage of life—back before the mills closed, before health care costs became prohibitive, before the cost of education exploded.

And yet we have to live with this stereotype of the spendthrift yuppie. And we will continue to have to live with the political resentments it causes in many younger and older people. Unless that is, we get the facts straight.

Which brings me to my next point. Why didn't the boomers save as much as their parents? I agree with all the factors mentioned in the report, but the report leaves out a very important one...one that is particularly relevant to the vast majority of baby boomers who are working class. Payroll taxes.

When my grandfather, a member of the so-called G.I. generation, was saving to send his children to college, back in the late 40s, the combined employer/employee payroll tax was just two percent.

When my silent generation father was saving to buy his first house, back in the early 1950s the payroll tax was just 3 percent.

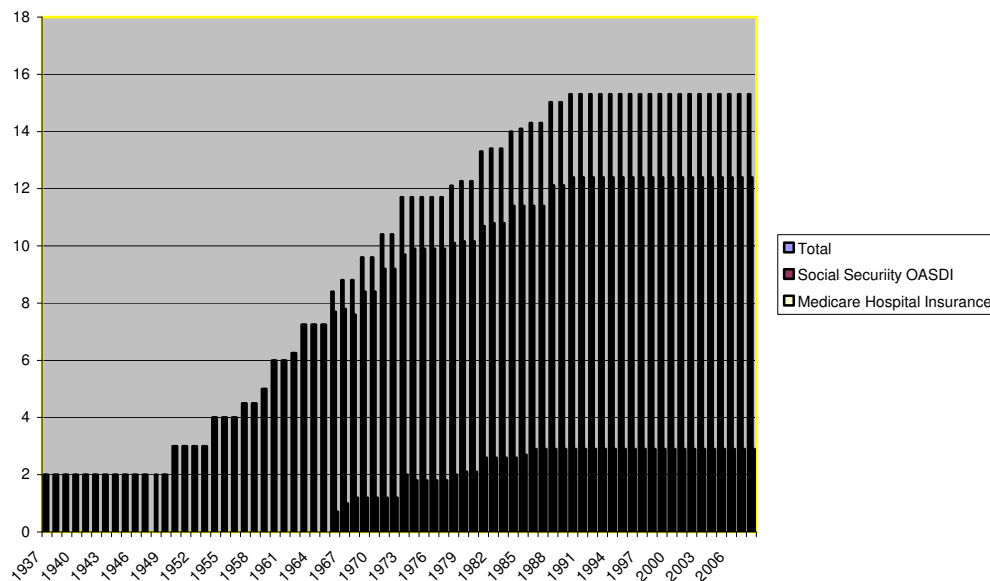
By the time the first baby boomers took their first summer jobs, in the mid-1960s, the payroll tax had already more than doubled to 7.25 percent.

By the time mid-wave boomers like myself took our first jobs in the early 1970s, the payroll tax had already spiked to 11.7 percent.

In 1990, the rate jumped to 15.3 percent and there it has stayed—a burden more than five times as big as that borne by the previous generation in the 1950s. Before most baby

boomers could even think about saving, they had to turn over nearly one out of every seven dollars they earned to the F.I.C.A. taxman.

**Social Security and Medicare Payroll Tax Rates
(percent of taxable payroll)**



Why did payroll taxes have to go up so much on this generation? Well, in large measure it was because the previous generation vastly expanded Social Security and Medicare for themselves in the 1970s, while pushing the cost onto the boomers and all subsequent generations. But that's not the only reason. The other big reason was a mandated pseudo savings program forced on the baby boomers.

Let me recall for you a little known turning point in the history of the baby boom generation, and of the nation.

The scene is a drab conference room in an obscure Ramada Inn in Alexandria, Virginia, during November of 1982. In this Ramada Inn, the AARP has rented suits of rooms, and so had the AFL-CIO. Maggie Kuhn and her Gray Panthers stalk the halls with pickets, led on by Claude Pepper, Mr. Social Security. Many business lobbyists are also present, though they work in quieter ways. Ordinary, hard working baby boomers, let alone their children, have no organized representation.

What's the occasion? Social Security is broke. It literally has only enough money to cover the cost of benefits for another few months. So, President Ronald Reagan and the leaders of the House and Senate have appointed a special commission, headed by Allan Greenspan to figure out what to do.

And here's what they come up with. It is not surprising given the players at the table. Every one agrees there will have to be an "artful" compromise between cutting benefits and raising taxes. And in fact the compromise is artful indeed. Enacted by Congress in 1983, it cuts benefits for baby boomers and all future retirees, while at the same time raising their taxes.

But that's not all. Some thoughtful people say, hey, let's not just raise taxes on boomers enough to cover the cost of bailing out Social Security for current retirees. Let's raise them still more so that boomers can start paying for the cost of their own benefits through a big build up in the Social Security trust funds.

And that became the plan. Force the boomers to save through extra heavy payroll taxes. Only a funny thing happened. Those extra payroll taxes the boomers were forced to pay to pre-fund their retirement...they were supposed to go into a so-called "lock box."—later made famous by Al Gore.

But instead, predictably enough, both parties figured out over the years how to break into lock box and spend what was supposed to be the baby boom generations nest egg for retirement on other stuff—primarily income tax cuts for the wealthy, a big military build up, and the financing of huge deficits in the government's overall budget.

The nest egg in that lock box? It's gone. And with Social Security on the verge of running a cash flow deficit, the rest of government will no longer get to live off the boomer's plundered savings.

So here we are, with 79 percent of the baby boom generation unprepared for retirement. What can we learn from this going forward?

Recently I did some back of the envelope calculations that I thought would illustrate the opportunity cost typical boomers have paid, and will pay because of the way policy makers have let them down.

Take the example of people born in 1958 who have earned medium household income for their age group throughout their lives. What if, back in 1983, when they were only 25 years old, the meeting at the Ramada Inn hadn't resulted in their being forced into a pseudo-savings program, but into a real one?

Specifically, what if instead of raising payroll taxes from 13.4 percent to 15.3 percent, policymakers had mandated that boomers save the difference in personal accounts? That difference amounts to a mere 2.1 percent of payroll.

Now that is a pretty meager savings rate. Moreover, most 25-year-olds had very little income back in those days. Their median household income was little more than \$14,000. In the first year, a 2.1 percent mandated savings rate would thus have amounted to less than \$300. But then again, they (we) were still a long, long way from retirement, with the miracle compound interest still having plenty of time to kick in.

With the benefit of hindsight, we can now see perfectly clear what would have happened had the country taken this course. Between 1983 and 2006, and S&P 500 had many ups and downs, but in the end it delivered a 10.9 percent return over the period. That means that an original investment of less than \$300 back made back in 1983 by a 25-year-old would have already turned into more than \$4,100 dollars today, and would be its way to becoming more than \$23,000 by age of retirement..

When you do the math, the magnitude of the opportunity lost is staggering. No one knows how markets will do over the next 15 years or so, of course, but lets suppose they don't do anywhere near as well as in the past and yield a return of only 5 percent. And lets suppose further that wage growth for this demographic slows in half from what it was earlier in their careers. This implies much lower annual contributions to their retirement nest egg in the years remaining. Still, the results from the compounding of early savings are phenomenal.

What a 2.1 percent savings rate could have done for boomers...

year	age	Median Income	Annual Savings	Value of Savings at age 67	Cumulative
1983	25	\$14,028	\$295	\$23,886	\$23,886
1988	30	\$19,675	\$413	\$19,972	\$131,294
1993	35	\$27,595	\$579	\$16,698	\$221,097
1998	40	\$38,164	\$801	\$13,767	\$295,569
2003	45	\$52,781	\$1,108	\$11,350	\$356,966
2008	50	\$70,465	\$1,480	\$3,470	\$401,699
2013	55	\$81,688	\$1,715	\$3,152	\$418,084
2018	60	\$94,699	\$1,989	\$2,863	\$432,967
2023	65	\$109,782	\$2,305	\$2,547	\$446,377
2024	66	\$113,075	\$2,375	\$2,482	\$448,859
2025	67	\$116,468	\$2,446	\$2,419	\$451,278
wage growth 83-93			0.07		
wage growth 94-2010			0.067		
wage growth 2010-24			0.03		
savings rate			0.021		
annual rate of return (1983-2008)			0.109		
annual rate of return (2009-2022)			0.05		

Imagine that, beginning 1983, young Americans with median household income had been spared the cost of contributing to the buildup of the social security's long since raided "lock box." Imagine, further that they had instead been mandated to invest the same amount of money in productive assets. Then, then they'd be looking today at the prospect

of enjoying a nest egg worth more than \$450,000 at age 67, even after assuming meager market returns during their remaining working years.

Woulda, Coulda, Shoulda. What's the point in calculating this opportunity lost? By this late date, there is no way the miracle of compound interest is going to bail out the vast majority of boomers who will be left struggling in old age.

Moreover, there is no way to retrieve the nest egg they were told they'd enjoy by paying extra payroll taxes to pre-fund their own benefits, because that money has already been spent. The country never even got around to having a serious discussion about mandated savings outside of social security until 2005, by which time the point was moot for baby boomers.

So now comes the paying time. But let us at least not let our children and grandchildren fall into the same trap. And let us not forget who got us into it.