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Luncheon guest speaker:
Lawrence H. Summers
Assistant to the President for Economic Policy
Director, National Economic Council

JAMES POTERBA: Good afternoon. It is my great privilege to welcome Larry Summers to this year's Retirement Research Consortium, which in its 11-year history has really become the premier gathering of researchers and policy makers interested in the core questions associated with retirement in the U.S. and other developed nations. It's a great honor to have Larry with us. Larry is, of course, one of the most distinguished economists and economic policy makers in the world. He currently serves as the director of the National Economic Council and the Assistant to the President for Economic Policy. But his past positions include the presidency of Harvard, the Secretary of the Treasury; he has been awarded the Clark Medal from the American Economics Association for his research contributions; and the list goes on and on. But I know for a tough audience like you that that doesn't cut much ice. So I wanted to remind you of Larry's contributions in the area of retirement security. To remind you that his early work on life-cycle saving and bequests helped to launch a now three-decades long research program assessing the extent to which life-cycle motives can explain household saving patterns in the U.S. economy. To remind you that Larry was one of the first to suspect that there might be some long-term mean-reverting tendencies in asset prices, which if there play an absolutely fundamental role in the asset allocation decisions households would make as they think about saving for their later years. To remind you that as a policy maker in the mid 1990's Larry helped champion the cause of introducing index bonds in the U.S., which of course for many years in the retirement saving discussions had been pointed to as a key lack for U.S. households as they tried to prepare for their retirement years. And we can't do that any more. So we don't have sessions on those topics any longer. And then finally in the late 1990's, teaming up the Treasury Department and the Labor Department, Larry helped to make it easier for firms to adopt default plans and other ways of trying to encourage participation and contributions in voluntary retirement saving plans. And I actually remember at that time getting a call from the Secretary of the Treasury's office asking if I could speak to the Treasury for a few moments and Secretary for a few moments. And when Larry came on the line, he said, Jimbo, I'm looking at this new working paper that says that there's these default plans encourage participation in 401(K) plans. What's the research community saying about this? Is this kind of holding up as people look at this? And that brief conversation crystallized for me what I think has been a key hallmark of Larry's work both as a policy maker and as a researcher. As a policy maker he has been extraordinarily successful at drawing on the latest cutting-edge research to help inform the policy issues of the day. And as a researcher he has been incredibly successful at focusing on the key policy questions to help direct the research that he and others around him are carrying out. I have been very fortunate to know Larry for a long time. We met when I was an

undergraduate. And he has been a mentor and an advisor to me throughout my career. I have always profited from listening to his insightful analysis on economic issues. And I just will share, as a closing thought, the last time he and I were on a podium together, which was at Stanford in the first week of March in 2008. Larry delivered a strikingly negative assessment of the state of the global financial and macroeconomic environment, pointing to large and growing real estate losses, fragility in the financial sector that had otherwise not been noticed at great extent. He concluded his remarks by saying, "we are facing the most serious combination of macroeconomic and financial stresses that the U.S. has faced in a generation and possibly much longer." And that was on a morning when Bear Stearns was trading at $75 a share. And I remember flying home thinking, you know, maybe Larry has just gotten pessimistic these days.
[Laughter]
And wondering whether this was really where we were headed. Well, those doubts only lasted for ten days, because we were together on a Friday and a week from Monday Bear Stearns had been taken over for $2 a share and we had begun writing a new chapter in global financial and economic history. Larry, this afternoon, will be talking about the Administration's economics program. And I am delighted to welcome him to the platform.
[Applause]

LAWRENCE SUMMERS: Jim, thank you very much for that generous introduction. Can we be a tag team wherever I go?
[Laughter]
You introduce me. That was really terrific. You know, it reminded me of the old Lyndon Johnson line about "I wish my parents had been here for that. My father would have appreciated it, and my mother with have believed it." And I really do appreciate what you said, and I have valued our friendship for what I was thinking must now be more than 30 years since you came to work as a research assistant for me in the late 1970's. You know, there has been an enormous amount of research assistant to augmenting technical change. If you think about what has happened with the computers and so forth. But I do not think that there is still to this date a research assistant who could do so much in so little time so accurately as Jim Poterba could in the 1970's. It was quite remarkable. NBER had remarkable leadership with Marty Feldstein, and now it can look forward to an even longer term of leadership from Jim Poterba. The Bureau and the economics profession are fortunate to have you in that position, Jim.
And I would say that our country is fortunate to have consortia and groups and conferences like this one. It is not the case that your average senator curls up on the average evening with an NBER working paper, I'm sorry to tell 'ya. And it is the case that the President walked in to my office one day and observed a copy of the Brookings Papers on Economic Activity sitting on my table, picked it up and looked at it and says, you know, Larry, I don't think I'll be taking this home for the weekend tonight to read. But the story Jim told about research on defaults and universal contribution and movements towards changes in IRA rules is a true story. And, as one who now has responsibility for a daily briefing of the President on economic policy where we take up an economic subject each day in addition to reporting on NetNews, I can tell you that the kind of research done at this conference, whether it's work that establishes that 70 is the

new 60, or whether it is work that looks at the surprisingly large number of people who have surprisingly low levels of financial assets. Or whether it is work that explores and tries to bring honesty to the question of funding, of adequacy of funding of defined benefit pension plans, it has an enormous impact over time on the course of public policy. Just because the causal chains are long and variable does not mean that the impact isn't very real. And one of the very great strengths of American economic policy, and I think it's actually an area where the United States is stronger than almost any other country, is the cross fertilization between a rich and vibrant research community in universities and in think tanks and the actual process of creation of public policy. Whether it's the two-way movement of individuals, of which I and Alicia and several other people in this room have been an example, or whether it is simply the example that comes from the reading and the communication, it really does make a very, very big difference.

I thought what I would do for just a few minutes this afternoon is talk about the Administration's economic strategy and touch on how some retirement security issues relate to it. Priority number one for the Administration, following the President's election, during the transition, was rescuing the American economy from what Paul Krugman had captured, the then-prevailing sentiment: “Let's not” -- what he wrote in January of 2009 – “let's not mince words, this looks an awful lot like the beginning of a second Great Depression.” The economy had lost 700,000 jobs a month in the quarter ending in February. GDP had fallen faster than any time since 1958. And the budget deficit was projected to be in excess of a trillion dollars. The market at one point was at the same level, inflation adjusted, that it had been in 1966. And options implied a one-in-six chance that the Dow would fall below 5,000. And the 38 percent of investment-grade corporate bonds would default over the coming decade. The large numbers of cities and states could issue debt despite their tax exemption at rates only significantly greater than the Treasury. Frankly, from the point of view of aged Americans, as from the point of view of other Americans, a single issue stopping the decline, bringing about a reversal, establishing an element of normalcy was of central importance. Without a halt to the freefall, no other economic policy was going to succeed and no other economic goal, whether it was the incorporation of technical change or the reduction of poverty, whether it was the promotion of old age security or the strengthening of access to higher education, whether it was the restoration of budget balance or the return of banks to health, no other objective had any chance of being met if the freefall was not contained. That's why the Administration moved immediately to contain the freefall.

With a diagnosis that started from the premise that what we had was a vicious cycle in which a weak economy contributed to a weak financial system and a weak financial system contributed to a weak economy, and that it was necessary to intervene strongly at both nodes. With a strong program of fiscal expansion, to raise incomes, increase the ability to repay loans, create demand in the economy. And with the strong set of measures to address excess foreclosures, to promote transparency and encourage capital raising on the part of the major financial institutions. We put that program in place. The Recovery Act was legislated in less than 30 days after the President took office. Already it has obligated more than $200 billion and led to the commencement of several thousand projects. The financial recovery has been manifest, if one looks at financial indicators, if one looks at credit spreads, many of which have now returned to pre-Lehman levels.

We have a long way to go. The problems were not created in a week, or a month, or a year. And they will not be resolved in a week, or a month, or a year. But looking at prevailing forecasts for GDP growth in the second half of this year, which on the part of almost all professional forecasters are now positive. Looking at the rate of job loss, which is running at half or less of earlier rates. Looking at market indicators -- not because policy can be judged by the market, but because there is information in markets -- more obvious indicators like stock markets; less obvious indicators like credit spreads, the spreads between LIBOR and federal funds, forward markets and what they suggest about housing prices some distance in the future What one sees is a substantial return to normality. In that context, it is reasonable to say that we are in a very different place than we were six months ago. That the sense of freefall of vertical decline has been contained. And that we are beginning to lay a foundation for future growth. And, at that point, it becomes crucial to think about the kind of foundation we want to lay and the kind of growth that we want to have going forward.

If one looks carefully at the last two recoveries, the last two expansions and even to some extent the expansion before, those expansions were supported, in very substantial part, by asset bubbles that drove consumption. In housing, most recently. In technology, in the broader stock market, in the previous case. They were associated with the very substantial financialization of the economy. They were associated, perhaps in consequence, with significant increases in inequality. And they coincided with important lags in crucial systems within the economy that are essential for our future: health care, education, energy. And, I would suggest, periods in which the economy moved forward. But related to those substantial increases in inequality, we did not make the progress in promoting retirement security that we might have hoped to make during a period of substantial expansion. And so the President was very clear. And this was something he was very clear on from the beginning, even in the darkest days. He was very clear that we could not pursue, in his judgment, a strategy of simply trying to restore employment and leave questions of economic structure for the future. That, as we were stimulating the economy, we had to think about what kind of stimulus that we were providing. That how could it not be a good idea, at a time when fiscal stimulus was necessary and large numbers of people were out of work, not to create jobs remedying a situation where the average hospital used less information technology than the average supermarket? How could it not be right, at a time when we needed demand in the economy, not to be engaged in substantial weatherization of buildings that the Federal Government owned where the payback was going to be three or four years? How could it not be right to be seeking to catalyze investments in high-speed rail and other key areas of infrastructure and, in particular, in renewable energy? And how could it not be right to take steps that would be desirable at any time but were essential as we were pursuing stimulus just on the brink of the time that the baby boom generation was going to begin to turn 65. And that is why the President has recognized the crucial relationship between retirement security issues and the long-run health of the federal budget.

Look, what's true if you study the federal budget closely is this: If you look not over three years, not over five years, but over 15 or more, if you don't get health care costs under control the budget is not going to be under control, no matter what else you do. And if you do get health care costs under control, if you do make substantial progress in slowing the growth of health care costs, the stakes are very large. Even several tenths of a percent, as Peter Orszag likes to point out very regularly, even several tenths of a percent contain a reduction in the growth rate of health care costs, if sustained, is larger than the impact of the Social Security deficit on a 75-year basis. That's why the Administration has done something that is unusual. At one level, we're doing something that this city has seen many times, a new progressive administration is pushing for measures that would substantially change health care and would widen access to health care. But at another level this is very different, because the question of cost is at the center of the debate. Now you can debate the specific measures of the specific programs that the Administration has proposed, you can debate the particular compromises that the political process may or may not make in the future, but what you can't debate is that cost is at the center of the health care debate. And you can't dispute that we cut taxes without thinking about doing it in a balanced budget way, thinking about what the pay-for was going to be in 2001 or 2003. We expanded prescription benefits, prescription drug benefits, without anybody considering the issue of what the pay-for's were and were they the right pay-for's and was the scoring of the pay-for's right, we just didn't think about the question. We launched a major war in the Middle East without anybody thinking about what the costs were. So let's have the best possible debate on all of this, but let's remember that for the first time we've got to debate where cost is going to be absolutely at the center.

Second, we've got crucial issues in thinking about the savings aspects of retirement security. You know, if somebody had said they had, they have a policy that would lift the personal savings rate from zero to six percent, I think most people in this room would have said that was pretty good. I think probably a fair number of people in this room who have one way or another written papers that have said, well, you know, it's really hard to do policy that will influence the personal savings rate by very much. We showed them. [Laughter.] Now, I would not recommend, I would not recommend incipient depression as an especially attractive strategy for trying to change the savings rate, I don't think, and there's such a thing as adjustment that is too radical. The aspect, there's an aspect of this that I think has gotten too little attention over time, though no doubt some researchers here have thought about it carefully, and that's this: You can imagine people having a wealth-income ratio of four because they have no debt and they have assets equal to four times their income, or you can imagine their having a wealth income ratio of four because they have six times their income in assets and two times their income in liabilities. And from the point of view of my 1981 AER paper or a lot of other analyses, those are basically the same thing, because what matters is the net worth to income ratio. But, if they are levered, then the volatility of their wealth is that much greater, even if the volatility of the underlying assets does not change. Now, what about the underlying volatility of their assets? The single largest asset in most Americans' portfolio is their house, and it is hard to believe that whatever sigma one attached to one's house five years from now, one should not attach a very substantially greater sigma today. I'm not sure what other, I'm not sure of what financial asset the same cannot be said. In a world of more levered households, and substantially greater leverage on the part of households, I think we need to think very carefully about target asset-income ratios, about target savings rate, and about retirement security, and that the more traditional static view that focused only on the ratio of net assets to income may not be appropriate.

A related aspect and one that is receiving very substantial policy attention right now is, if you like, the microeconomics of -- the microeconomics of saving. We have much more extensively, we have extensive issues around the transactions costs, the undisclosed risks associated with a range of savings vehicles. While credit cards have been much in the news, and we have legislated in that area. While overdraft fees have seized the headlines in the last several days, there is, in my judgment, room for considerable policy attention to the fraction of the return on individuals' savings that is produced in one way or another by marketing, administrative, and other kinds of transactions costs. And one crucial area of exploration, as we pursue financial regulation, will be preserving the range of choice that we have, but making sure that individuals are given a fair opportunity to understand what they buy and that the forces of the market are properly channeled towards containing transactions costs for the benefit of retirement security.

Finally, there will be the set of questions, and these are also implicated by recent trends, if one looks at the data, one of the surprising features of recent data is that labor force participation among the relatively aged has been strikingly robust during the current recession. Normal pattern is that there's cyclicality among those who do not absolutely have to be working, and part of that has traditionally manifested itself in cyclicality in the older labor force. I don't think anybody understands why. One natural hypothesis is that depleted assets and increased uncertainty lead to delayed retirement from the labor force. I happen to know from prior experience that from the very atypical segment of the population -- university professors -- that there is very substantial sensitivity of retirement behavior to TIAA-CREF, TIAA-CREF performance. I suspect that if you extrapolate current trends, if you recognize the consequences of increased financial uncertainty, if you recognize the consequences of longer lifespans and increased health and ability and reduced disability on the part of the aged, that more people are going to be working longer. And I think this will push us to think very hard about our labor market institutions and the traditional pattern in many large organizations in this country where an individual works through their lifetime in an organization, periodically being promoted to a position of higher and higher responsibility and pay, and then at a certain point leaves and stops working altogether. That is a less typical pattern today than it was a generation ago, and I think it is going to be a substantially less typical pattern a generation from now. And how we adapt to take advantage of the tremendous human resources that we have at our disposal as individuals adjust their efforts over the life cycle will I think be a very substantial challenge. I don't think there will have been a more consequential decade in economic policy than the decade we are now entering. Or at least not a more consequential decade since the 1930's. I think retirement security issues are a crucial part of that, and I think the contribution of research like that represented here will be very substantial. Thank you very much.

[Applause]

I'd be happy to answer a couple of questions. Yes, sir.

Q: Drilling down a little -- Mike Wine with BNA. Drilling down a little further, would you see as a possible consideration amending the tax laws in terms of encouraging phased retirement so people can retire and take a pension for which you're eligible and not be tax disadvantaged if they should go to work or work part time somewhere else?

LAWRENCE SUMMERS: Now, how do I answer that question? [Laughter] Experience teaches me that something like that is difficult. If I say we're open to all possibilities, you

will write a headline that says, "Summers open to possibility of pension reform." If I say no, that's not something we're considering, you will write, "Summers rules out tax pension alternative." [Laughter] So that question of how to give an answer that will not change your prior probability on that question at all -- [Laughter] -- is a very difficult one, but I think the answer has just occurred to me. You should continue to believe whatever prior probability you attach -- [Laughter] -- to that question as we move forward.
[Applause].
Yes, sir.

Q: Are there any differences -- A: What's your name? [inaudible]

Speak into the mic.

Q: L. Milliken, AM Media. Are there any differences in looking towards retirement and investing that you feel safe in talking about in differences between men and women? [Laughter]

LAWRENCE SUMMERS: You've, you've just -- you've just put it, you've just put at substantial risk the health of my staff. [Laughter] They watched my introductory remarks with considerable anxiety, they have just been breathing, I suspect, a sigh of relief because I had not announced my intention to be provocative, and now you have just put their health at risk. I think I will move to the next question.
[Laughter]
Alicia.

Q: Larry, I'd like to give you an easy one. When is the Administration going to address Social Security and what principles are going to -- [inaudible]

LAWRENCE SUMMERS: Over the course of the President's term the Administration will, I'm confident, address Social Security, and I think it will address Social Security from the perspective that in an increasingly uncertain world -- uncertain because of the greater volatility in financial markets that we spoke of, uncertain because of the greater leverage the households find themselves with, uncertain because if you want to speak in a bloodless way about it, the value of people's human capital is much, much more uncertain in a volatile economy -- that the protection of what's the bedrock of the system has to be an absolutely central value. And so, reforming Social Security in a way that will assure people that it is something they can rely on, that it is a base from which they can build their retirements, their retirement security, would, I'm confident, be at the center of any approach that would be, any approach that would be taken.

Q: [inaudible]

LAWRENCE SUMMERS: Yes, sir.

Q: Wait for the mic.

Q: I'd like to point that apropos of the Social Security, I'm a consulting actuary. I've been studying the actuarial basis of Social Security for about 10 to 15 years, and my conclusions have been that the actuaries of Social Security, with the backing of the trustees who are normally conservative, came up with a set of assumptions which made the costs higher than they should be. And that if you used an appropriate set of assumptions, then there's a slight profit and not a deficit in Social Security. Secondly, you have to take into account the index, like you're thinking about, the future of Social Security, that there's been a tremendous demise of the ability to, for people to have retirement plans through their corporations or through their own efforts. A lot of plans have been terminated. People have been thrown out of the stock market, which, as you point out, is still volatile. And that, contrary to the normal thinking, I think you should really be considering raising the Social Security benefit from the current 41 percent of the average worker up to 70 percent, and it not cost that much for a variety of reasons, and that I would hope that you'd think about these things and not think of the negative terms, about the mix and volatility and human capital going down, but think what positively would could be accomplished.

LAWRENCE SUMMERS: 41 to 70, I think I am not the person who made the most provocative suggestion -- [Laughter] -- at this session. You know, more seriously, sir, with respect to the projections, there's a range of views, and I appreciate yours, and others have different views. I see my friend Steve Goss here, who's got so much experience with how these projections play out, and obviously any effort at 75-year forecasting has to be viewed, has to be viewed with enormous uncertainty. I think you're absolutely right, and I should have said when I spoke about the increased uncertainties in the world, the movements from defined contribution, from defined benefit to defined contribution plans, and the increased uncertainty associated with defined benefit plans is something that I should, is something that I should have, that I should have mentioned as well, and that's obviously a factor in the equation as one thinks about Social Security. Thank you very, very much.
[Applause]

JAMES POTERBA: Larry, thank you very much for joining us today, I will report back, when I get to Cambridge, that you've made your teachers at MIT and Harvard proud with using posterior odds ratios in answering a question from the media. We will try our level best to continue to write the kind of working papers which you and your staff will find productive and useful in the future. I believe we now will take a brief break to return to the regularly scheduled program, and we'll rejoin very soon. Thank you all.
[Applause].