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A Temporary Return to Thrift

Will the aging of America's population fatten the nation's skinny saving rate? A new NBER study by **Alan Auerbach** and **Laurence Kotlikoff** predicts that for the next 30 years, demographic forces *are* apt to favor thrift. Beyond that, though, a continuation of current trends is more likely to encourage consumption.

Whatever its future course, there's little doubt that saving languished in the 1980s. According to **Demographics, Fiscal Policy, and U.S. Saving in the 1980s** (*NBER Working Paper No. 3150*), personal saving averaged less than 4 percent of household income in the mid-1980s versus 8 percent in the 1970s and nearly 7 percent in the 1950s and 1960s. Broader, more accurate measures make the 1980s' saving rate look less puny, but depict an even bigger departure from past norms. The national saving rate —including assets accumulated by business and government—fell from 12 percent to 7 percent, for example.

Saving should stage a comeback now. The personal saving rate already edged back up to 5.5 percent last year. As more Americans enter high-earning, high-saving middle age, the authors' calculations show, the national saving rate could exceed prior averages for the next 30 years. If that happened, the huge U.S. current account deficits could turn into surpluses in the 1990s. Instead of borrowing abroad to bridge the gap between domestic saving and investment, the United States would again become a net lender to the rest of the world.

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However, the revival of thrift won't last forever. By 2040, one in five Americans—versus just one in ten now—will be 65 or older. The share of prime-age workers between 25 and 55 will shrink. And, despite a relative decline in the number of children, the ratio of dependents to wage earners will soar. That means, all else being equal, that Americans ultimately will consume more and save less than they do today. The decline in the saving rate would set in around 2020. Auerbach and Kotlikoff comment, "The prospect of even lower saving rates in the future is daunting indeed."

But demography hardly is destiny. If saving patterns depended on nothing else, demographic trends should have turned the 1980s into an era of thrift instead of an apogee of consumerism. In particular, the authors write, the 1980s' saving rate should have been twice as much as it actually turned out to be. SN

Unions Depress Employment Growth

British trade unions may depress the growth rate of employment in an establishment by as much as 3 percent per year, according to an NBER study by **David Blanchflower, Neil Millward,** and **Andrew Oswald.**

In **Unionization and Employment Behavior** (*NBER Working Paper No. 3180*), they analyze the employment patterns of a random sample of 2000 British workplaces between 1980 and 1984. They find that one-third of the nonunion, private sector workplaces grew by more than 20 percent, compared with only 8 percent of workplaces with union closed shops. Similarly, 15 percent of the nonunion workplaces declined by one-fifth, versus 37 percent of the workplaces with closed shops.

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Size of workplace is also an important determinants of the rate of employment growth. The biggest plants declined fastest. Eighteen percent of establishments with more than 2000 employees grew by at least 5 percent 1980 and 1984. This compares with 36 percent of workplaces of between 25 and 49 employees.

Blanchflower, Millward, and Oswald find this negative effect of unions regardless of industry, type of workplace, or region. Moreover, unionization discourages employment growth beyond its effect on either the workers' own wage or the wage prevailing in the local labor market. They conclude that, on average, Britain's unionized plants grew more slowly and declined more quickly than did nonunionized plants.

You Can't Make 'Em Pay!

Recent proposals to require managers to pay out their companies' "free" cash flows and not waste financial capital may not be effective, according to NBER Research Associates **Glenn Hubbard** and **Peter Reiss.** They study an earlier effort to force corporations to pay out earnings in increased dividends and find that the attempt was only partially successful.

In **Corporate Payouts and the Tax Price of Corporate Retentions: Evidence from the Undistributed Profits Tax of 1936–8** (*NBER Working Paper No. 3111*), Hubbard and Reiss study how corporations responded to the Undistributed Profits Tax of 1936–8. Marginal tax rates under this law ranged from 7 percent for firms paying out more than 90 percent of their net income to 27 percent for firms paying out less than 40 percent of income. Small firms, banks, and insurance companies were exempt.

Hubbard and Reiss report that this tax raised revenues of $145 and $176 million in 1936 and 1937, compared to regular corporate income tax revenues of $950 million and $1.1 billion, respectively. Almost 58 percent of corporate income tax returns in 1936 reported no net income and hence were not subject to the tax on retained earnings. Of the remainder, only 22 paid no special tax, while 18 percent paid a marginal tax rate on retained earnings of at least 17 percent. Thus a significant fraction of firms in 1936 and 1937 chose to pay the tax rather than to pay out their earnings in dividends.

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Hubbard and Reiss analyze the experience of 26 large petroleum companies in greater detail. They report that 13 of the petroleum companies increased their divi-

dend payouts by over 40 percent, and six companies more than doubled their payouts in 1936. However, in 1937, when earnings grew substantially, dividends responded only weakly to the tax. Only seven companies increased their dividend payments by over 40 percent, and four companies actually reduced their payouts. There was almost no response at all to the tax in 1938, Hubbard and Reiss find.

They suggest that in time the managers of the oil companies found other ways of reducing their tax payments without having to increase dividends. For example, one of the companies declared a special bonus for all employees in 1937. Some companies raised pay for officers and directors. Also in 1937, three of the companies spent extraordinary amounts to set up benefit plans.

Managers also responded to the tax by drilling more oil wells. Hubbard and Reiss report a 20 to 30 percent increase in oil wells drilled in 1937 that could not be explained by other variables such as the price of oil. In short, in reaction to the tax, managers converted to expenses what otherwise would have been retained earnings. DRH

Managed Exchange Rates Reduce Volatility but Not Uncertainty

The reappearance in 1973 of flexible exchange rates, both floating and managed, has resulted in neither purchasing power parity nor autonomy for domestic policy. Rather, there have been costly swings in relative prices and preoccupation with international economic pressures. These problems should not come as a surprise, though; there were clear historical precedents in the period between the two world wars.

In **The Comparative Performance of Fixed and Flexible Exchange Rate Regimes** (*NBER Working Paper No. 3097*), Research Associate **Barry Eichengreen** finds that exchange rates were four times more volatile, on a weekly basis, during the free float of 1922–6 than they were when managed floating was in vogue from 1932–6. Even in the later period, though, government policy was subject to major shifts that were difficult to predict. Intervention to damp the fluctuation of floating rates therefore did not deliver a commensurate reduction in exchange rate uncertainty or reduce the exchange "risk premium" proportionately.

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In contrast, real exchange rates were remarkably stable during the gold standard years, 1926 to 1932. That is "impressive given the major terms of trade shocks to which the world economy was subjected" with the onset of the Great Depression, Eichengreen writes. Fixed rates delivered a greater degree of international financial integration, but it came only gradually as credibility increased less because of the fixed rate system as a whole than because of individual national policies.

Eichengreen concludes that the benefits from a reduction of exchange rate volatility depend on how it is achieved. The gold standard was maintained by "systematic adaptation of monetary and fiscal policies." In contrast, the managed float that succeeded it was accompanied by only limited policy coordination.

Fixed rates also resulted in more extensive international capital movements, Eichengreen finds. But there was no *direct* correspondence between the degree of exchange rate flexibility and the volume of capital flows. Pervasive controls in the 1930s retarded the flow of capital compared with the 1920s. Real interest rate differentials on average were five times as large under the managed exchange rate regime as under the earlier free float. Capital controls also were more prevalent in the early 1920s than in the later gold standard years, Eichengreen notes. This contradicts the general presumption that capital controls are associated with fixed rates. LB

Recent NBER Books

Lotteries Book Is Published

Selling Hope: State Lotteries in America, by Charles T. Clotfelter and Philip J. Cook, is available from Harvard University Press for $29.50.

Selling Hope, the final report on an NBER study conducted by Clotfelter and Cook, comprehensively describes lottery games and prize structures, who plays, why they play, and how they play. It shows how low-income people are disproportionately represented among lottery customers and how a small fraction of all players account for a major share of lottery revenues.

In addition to questioning who bears the burden of lottery finance, Clotfelter and Cook ask whether lotteries have been truthful in advertising, and whether they can provide a stable source of revenue. Finally, can lotteries' businesslike orientation be reconciled with the public interest? This book should interest policymakers, academics, and anyone who wants to learn more about this important source of state revenues.

Clotfelter, an NBER research associate, and Cook are both professors of public policy studies and economics at Duke University.

This book may be ordered from: Harvard University Press, 79 Garden Street, Cambridge, MA 02138.

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Working Papers are intended to make preliminary research results available to economists in the hope of encouraging discussion and suggestions for revision. The **Digest** *is issued for similar informational purposes and to stimulate discussion of Working Papers before their final publication. Neither the Working Papers nor the* **Digest** *has been reviewed by the Board of Directors of the NBER. Preparation of the* **Digest** *is under the supervision of Donna Zerwitz. The articles indicated by SN, DRH, and LB were prepared with the assistance of Sylvia Nasar, David R. Henderson, and Lewis Beman, respectively.*

Individual copies of the NBER Working Papers summarized here (and others) are available free of charge to Corporate Associates and other supporters of the National Bureau. For all others, there is a charge of $2.00 per paper requested. Please do not send cash. For further information, please contact: Working Papers, NBER, 1050 Massachusetts Avenue, Cambridge, MA 02138; (617) 868-3900. Abstracts of all current National Bureau Working Papers appear in the **NBER Reporter.**