The Hardest Job in America…Yours!

No, Mr. President, you are after Tony

President of the United States is generally regarded as the most difficult job in America. I respectfully disagree. Though he counts 535 politicians among his co-workers and does not receive hazard pay, the job currently held down by Barack Obama comes in a distant third. The holder of the most difficult job in America for 2010 (and the foreseeable future) is the American Consumer. Kate Gosselin's dance instructor took the #2 spot.

The situation in which the consumer finds himself is analogous to a hot air balloon on its last tank of propane. After decades of profligate spending (and little savings) the consumer has inflated a nice, giant economy. In 2010, he finds himself older, over-leveraged and under-saved for a rapidly approaching retirement. Though a spike in unemployment has reduced his income, the consumer is being asked to increase spending to prop up this sagging balloon of an economy and, while he is at it, to increase retirement savings so he can also spend in the future. A mission impossible if there ever was one.

Why is the consumer so important?

When a consumer earns a dollar, he can do one of three things with that dollar; 1) spend it; 2) save it so that it might be spent in the future; or 3) pay back a borrowed dollar spent in the past. We care a lot about consumer spending because it makes up 60% to 70% (depending on who is doing the counting) of our GDP. Because consumer spending is so critical to the economy and because a dollar spent today is a dollar that cannot be spent tomorrow, it is important for the stability of the economy that current and future spending be balanced.[1]

The high level of consumer spending and the demand it created over the last several decades fueled innovative products and technologies that has improved our collective quality of life and created entire industries that employ millions of people. However, this imbalance in favor of spending over saving has caught up with us, and we have created an economy that is larger than what we can currently (or wisely) sustain. The result will be a prolonged period of, to use an economic term of art, yuckiness.

It's Spud's fault

If only there were someone's feet at which we could lay the blame for our current dire straits. Fortunately, there is. His name is Arnold K. Melin.

Mr. Melin ("Spud" to his friends) sought a trademark for the Hula-Hoop in 1958. He and friend Richard Knerr subsequently founded Wham-O and within a year sold over 100 million of the plastic rings in the United States alone. Dizzy from all of that spinning, Americans went into a spending frenzy from which it never recovered. As illustrated in Figure 1, within a year of the introduction of the Hula-Hoop, the increase in earned income NEVER equaled the increase in consumer expenditures again.

[1] Consumer spending is made up of the decisions of hundreds of millions individual consumers. While it is impossible to *control* consumer spending in a democracy, fiscal policy can e*ncourage* consumers to make certain consumption versus savings decisions. One might argue that our fiscal policy is skewed too heavily to favor consumption over savings, but that is the topic of another article.

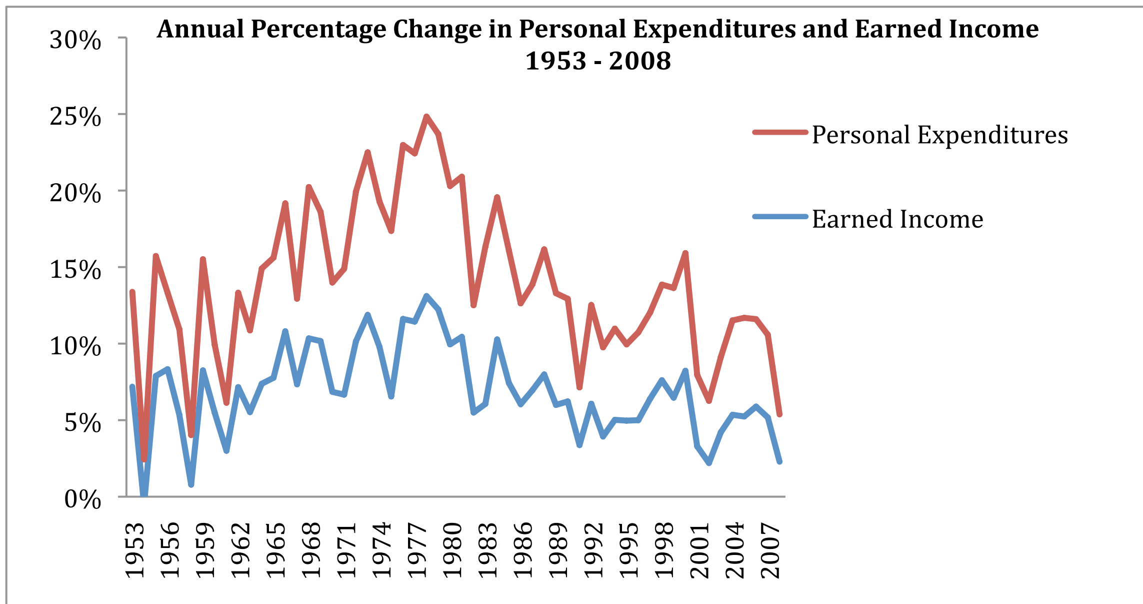

Figure 1. Source: Bureau of Economic Analysis

If consumers are increasing their spending at a faster rate then they are increasing their income, they must be taking on debt. In 1953 (the earliest year for which data is available), household debt was 47% of earned income. By 2009, that figure rose to 173% (Figure 2).

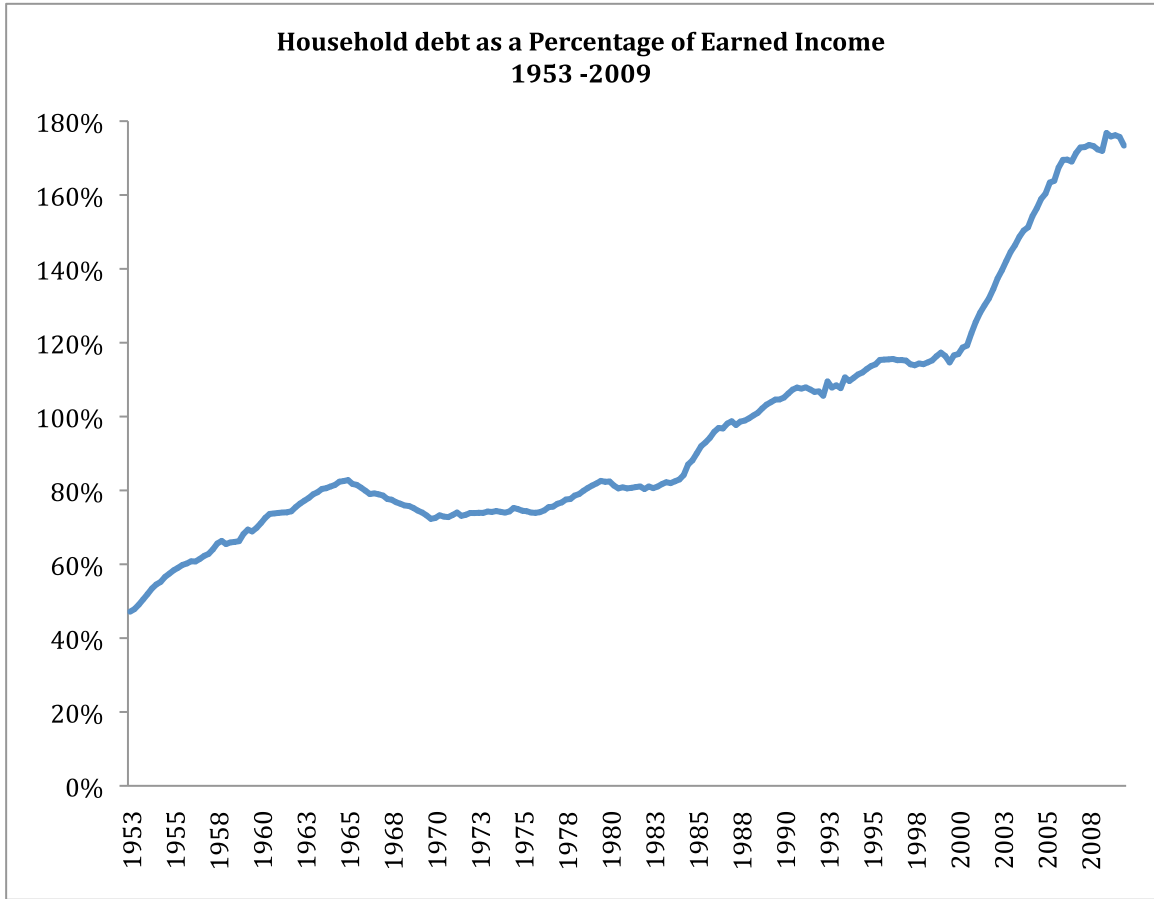

Figure 2. Source: Board of Governors of the Federal Reserve System and the Bureau of Economic Analysis

A pair of Manolos in every pot

Americans have not only increased how much then spend, but also *how* they spend. At the end of World War II, millions of American veterans returned home after years on the battlefield. They returned to families that spent years living under war rations of items like meat, coffee, gasoline, and shoes, and some goods, like nylons and tires, that were virtually unavailable. The result of this tremendous pent-up demand was of course a boom in consumer spending, but this spending was, more or less, on loosely defined "necessities".

Figure 3 depicts spending on recreational goods and services (as defined by the folks at the Bureau of Economic Analysis) as a percentage of personal disposable income. From 1953 through 1959, recreational spending hovered around 4.8% of personal disposable income. Between the time the 100 millionth Hula-Hoop rolled out of the factory and 2008, recreational spending had a relative increase of more than 75%, accounting for 8.5% of personal disposable income.

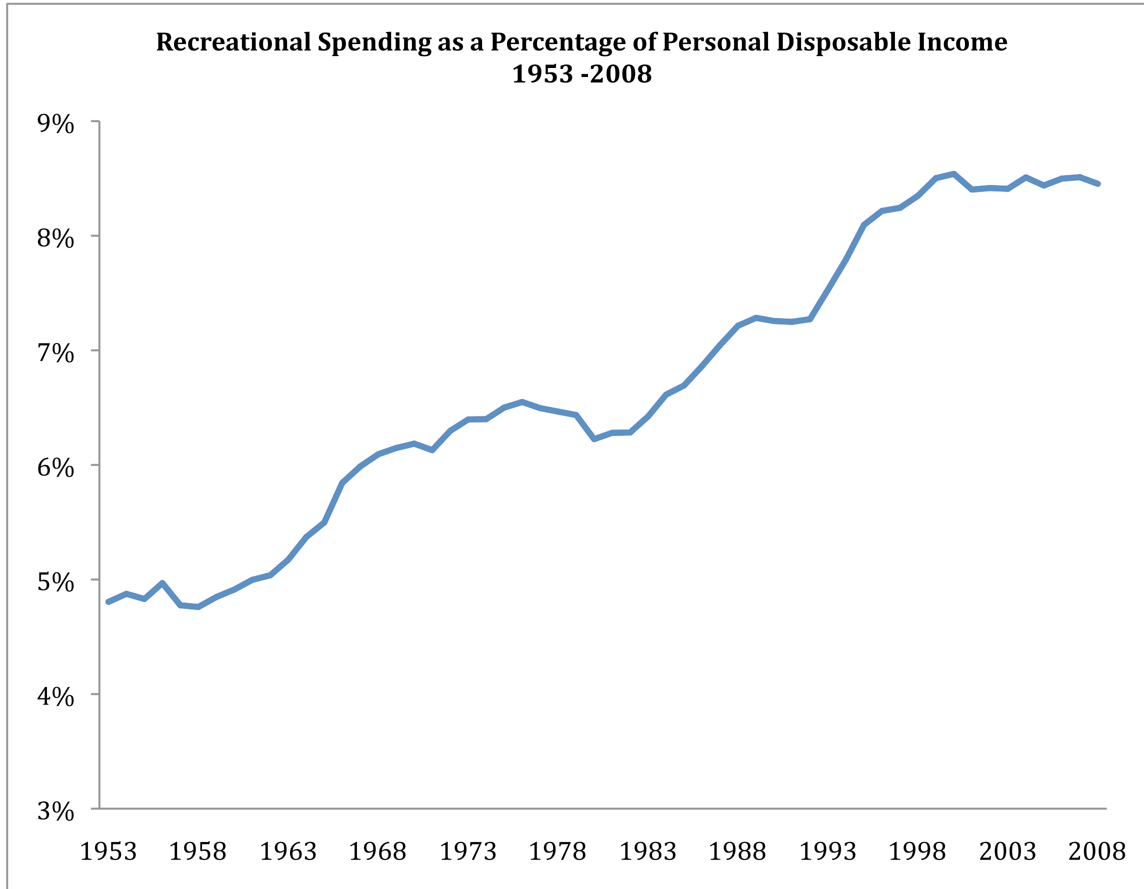

Figure 3. Source: Bureau of Economic Analysis

To be sure, the BEA's definition of "recreational" and "non-recreational" spending is not the same as "frivolous" and "worthwhile" spending, but it is interesting. Another interesting change in spending behavior can be found in housing.

<u>And the hallway to your left leads to the East wing of the home…</u>

Though the size of the American family has been decreasing for decades, the size of our homes is increasing. According to the National Association of Home Builders, the average home size in the U.S. increased by 66% to 2,330 square feet in 2004, from 1,400 square feet in 1970. Not surprisingly, this increase in size was accompanied by an increase in relative price. As illustrated in Figure 4, the ratio of the median home sale price to median income went from about 3.1 in 1975 (the earliest date data was available) and peaked at almost 5.1 in 2006 before falling to 4.6 in 2008. Even after the fall in 2007 and 2008, home prices still increased more than 45% relative to income since 1975.

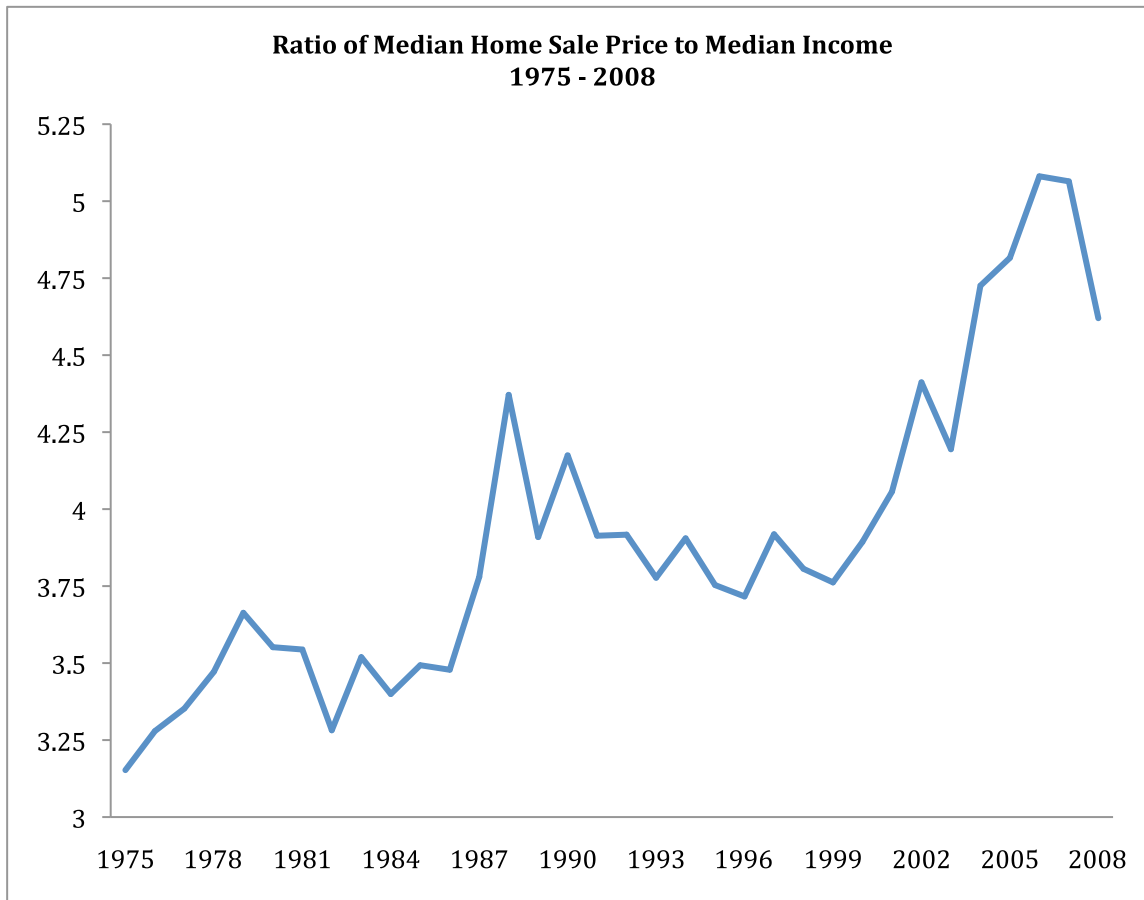

Figure 4. Source: U.S. Census Bureau

<u>Hey brother can you spare a dime</u>
If your spending grows faster than your income for 50 years (Figure 1), you must be saving less. According to the Bureau of Economic Analysis, Americans were saving about 8.5% of their personal disposable income when they first began throwing their backs out on Spud's and Richard's hoop; by 2007 they were saving only 1.5%

It stands to reason that if one's savings rate steadily decreases over a few decades one will not accumulate much wealth. According to the 2007 Retirement Confidence Survey conducted by the Employee Benefit Research Institute (EBRI) and Mathew Greenwald & Associates, Inc. (prior to the market's swan dive of 2008-9), 59% of all workers have less than $50,000 in total savings and investments. More disturbingly, 41% of workers over age 55 have less than $50,000 saved.

Compounding the problem of negligible savings heading into retirement is the fact that fewer Americans are covered by a pension plan. According to a June 2007 study by the EBRI, 84% of private sector workers enjoyed a traditional "check for life" pension plan in 1979. By 2005, only 37% of private sector workers were covered by a defined benefit (DB) plan. The lack of guaranteed income in retirement is actually worse than these statistics suggest. More and more employers are freezing their DB plans so that the percentage of current private sector workers that will get meaningful income from

their DB plans will be much less than the percentage that are technically "covered." Watson Wyatt's annual analysis of DB plans found that 4% of Fortune 1000 companies that offered a DB plan froze plan benefits. By 2009, the percentage of frozen plans stood at 31%.

At least you have your health

Doctor: I'm afraid I have some bad news.
Patient: Give it to my straight, doc. I can take it.
Doctor: You have at least 25, maybe even 35 more years to live.

Though Americans have less saved and less guaranteed income in retirement, they will need to make those scarce resources last even longer. According to the Society of Actuaries a 65 year-old husband and wife couple has a 50% chance that at least one of them will live to age 92. Living longer, however, doesn't mean you don't get sick. According to a March 2010 study by Fidelity Investments, that same 65 year-old couple retiring in 2010 can expect to pay $250,000 in out of pocket medical expenses in retirement. This represents a 56% increase since Fidelity's first study in 2002. If medical expenses continue to increase at the same rate, 65 year-old couples retiring in 2023 can expect to pay over half a million dollars in out of pocket expenses.

What about my rich Uncle?

Don't expect to benefit from government largesse. Uncle Sam already has enough debt to work off. The Federal Debt is estimated to be 94% of GDP. Though the U.S. was still working off World War II, Federal Debt as about 60% of GDP. It fell steadily to 33% in 1979 when it resumed its ascent.

What's a consumer to do?

My advice to you, dear reader, is to employ a two-pronged offensive. First, save. Save as much as you possibly can. I have no suggestions as to what you might invest your savings in mind you, but carving out a nice nook inside your Tempur-Pedic probably isn't the worst idea.

The second prong; shout from the hilltops the good news; the recession is over, it is time to spend! Spend! Spend! Beseech your co-workers to ignore the fear-mongers; 90-day mortgage delinquencies are down! Put the Sunday circular in your neighbors' mailboxes and email discount codes to friends. Drive elderly family members to the mall. Someone needs to spend us out of this mess, and re-inflate our balloon, just don't let it be you. Let the consumer do it.

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