Rhode Island Policy Reporter

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The best we can do?

THE DEBATE OVER THE STATE BUDGET last spring was dominated by arguments over the pensions we award to state employees and teachers. These pensions were deemed too generous by many, and the result is that they're now less so. The cost of these pensions to state and local governments has declined substantially but not permanently. The forces that pushed the pension costs up—a disastrous stock market in 2001-2003—will do so again this year. But it won't be possible to reform the pensions again.[1] One of the recurring themes in discussions about the pensions was resentment that state employees should have a benefit that many citizens don't have. Some say that the way to solve this is to deny the state workers the benefit. But here at **RIPR** HQ, we wonder if that's all we can do.

For the past 25 years, private sector pension coverage rates have held fairly steady at about 50%. That is, about half of our citizens have some kind of pension coverage, not including Social Security. In terms of business size, about two-thirds of workers at large companies (over 100 employees) are members of a plan, but only around one-third of workers at small companies.[2] The other numbers in the table on page 2 break out roughly the way you'd think: high-paying jobs and white collar jobs are much more likely to provide benefits that include a pension than low-paying jobs and service jobs. Big firms are more likely than small firms, and full-time employees are more likely than part-time. What may seem a surprise is the low coverage rate: fifty percent is not impressive.

The rates of pension participation grew substantially in the 1950's and 1960's, but they have been essentially unchanged since the 1970's. What's more, there's no reason to expect these numbers to improve. In fact, most of the important employment trends—from manufacturing to services, from high wages to low, and from full to part time—imply that we can expect the picture to deteriorate from here.

This is to say that, 70 years after the New Deal, about half of Rhode Island's working citizens—over 240,000 people—have nothing but Social Security to look forward to for their retirement. Social Security is probably the most successful anti-poverty program our nation has, but the program provides a retirement income of only around a third of one's working income, or less. A Social Security-financed retirement may not be destitute, but it's not so comfortable, either. But taxes paid by these citizens who don't have comfortable retirements ahead of them finance comfortable retirements for teachers and other government employees. Is there any wonder that resentment is the result?

It's not true that the only solution to the disparity is to degrade or eliminate government pensions for teachers, which seems to be the preferred talk-radio solution. Why can't Rhode Island create a pension system for its less fortunate workers?

A system that withheld, say, 3% of one's salary and required a 3% match from employers—a defined contribution plan, in the pension parlance—could fill a substantial part of the hole in our retirement savings. Using the investment return rates reported by the state Employee Retirement System, a career's worth of minimum-wage work in such a system could easily accumulate over $100,000, enough to finance a retirement income between half and two thirds of one's pre-retirement wages, depending on how wages fluctuated over the years. Combined with Social Security, this would replace two-thirds or more of that worker's income at retirement.

A system that was available to all employees in the state would allow someone at the low end of the em-

AS220

STINK TANK

Editor's note: As of this edition, we are pleased to report that **RIPR** will become a publication of the new **AS220 Stinktank Press**. The new association will allow us to expand the newsletter and redouble our efforts to invite contributors to join in the fun. With the Stinktank, we are planning several public events this fall and winter to promote the discussion of important public policy issues: hearings for proposals that should be in the legislature, but aren't, held for a committee of concerned citizens who should be in the legislature, but aren't. Watch for them at *whatcheer.net*. –TS

[1]The Governor could easily ameliorate the difficulty by re-amortizing the unfunded liability of the system, but he's given no indication that this is on the table. The problem and the solution were outlined in **RIPR** issue 9, available at *whatcheer.net*.

[2]This and the data in Table 1 are from the Bureau of Labor National Compensation Survey, March 2005. See also *pensioncoverage.net* for an interesting report put together by the Ford, Mott and Annie E. Casey Foundations, along with the AARP, AFL-CIO, and several insurance companies.

Table 1: Percentage of workers covered by employee benefits. From the BLS National Compensation Survey, March 2005. The wage numbers refer to the average wage of an occupation. The defined benefit column and the defined contribution column don't add up to the pension column because many companies offer both.

	Pension	Def. ben.	Def. cont.	Medical
All workers	50	21	42	53
White collar	61	24	53	58
Blue collar	51	26	38	61
Service	22	7	18	27
Full time	60	25	50	66
Part time	19	9	14	12
Union	85	72	43	83
Non-union	46	15	41	49
<$15/hr	35	11	29	39
>$15/hr	71	34	59	72
Establishments				
Goods producer	64	32	50	70
Service	47	18	39	48
1-99 employees	37	9	32	43
100 and up	67	36	53	65
Locations				
Metropolitan	52	22	42	54
Non-metro	44	15	38	49
New England	51	21	42	49
Mid-Atlantic	55	28	42	52

ployment scale to contribute to the same account through multiple employers and a system that allowed variable contribution rates could help people who are already almost at retirement age. Such a system could only work if it was easy enough for employers to participate (or mandatory), so it would be important to keep the hassle level down. But the overhead for such a system would be small: the state already requires employers to contribute to unemployment and disability insurance, and it already manages substantial investment funds for the employee pension system.

The near-term benefits wouldn't be huge. But the benefits would grow with time, and could eventually be enormous and widespread. So how about it? Do we just continue to complain about how teachers get a pension and no one else does? Here's something to do about it. ■

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Book Review

Debating policy

John Kenneth Galbraith
His Life, His Politics, His Economics
Richard Parker, Farrar Straus Giroux, 2005

Through all the smoke of modern political conflict, it's often hard to tell that, at root, the conflict is really about what government policy should be. It sounds dry and academic to say so, but beyond all the fuss about the "character" of this candidate or the indiscretions of that one, the real issue is what our government *does*—for us and to us. The happy view is that the conflict is a debate, of sorts. Others might characterize it as war. Either way, a serious problem is that when the various sides make up a cacophony of dire predictions and suggestions to counter, it is often very difficult to judge who is correct.

The winners of the "debate" are the ones whose policies the government enacts, but in a complicated world, the connection between policy and outcome is not always clear. When a catastrophe *doesn't* happen, how do you know what prevented it? The answer is seldom very clear. The Asian financial crisis of the late 1990's didn't provoke a global economic meltdown, but why not? Was it the intervention of the US Treasury Department? Did the Federal Reserve's actions calm US financial markets? Or was it the European central banks?

When a disaster doesn't happen, how do you know why it didn't?

But even though it seldom happens that the winners can be sure of their success, it is often possible with hindsight to vindicate the losers. It is crystal clear, for example, that our government should have paid more attention to the cautions of John O'Neill in 2001,[3] and in 2005, it's pretty easy for most to see that the George Bush Sr.'s explanation for *not* invading Baghdad in 1991—he was afraid of getting bogged down with no clear exit strategy—look positively prescient compared to the events since our 2003 invasion. After Katrina wiped up New Orleans, past predictions of exactly that, and denials of requested funding to address the peril, almost seemed to come bubbling out of the muck.

With this in mind, one can say that John Kenneth Galbraith is one of the most fortunate men in 20th century American politics. Among the nation's most prominent economists, and a trusted adviser to Presidents Roosevelt, Kennedy, Johnson (as well as candidates Adlai Stevenson and Eugene McCarthy) he nonetheless lost vir-

[3]O'Neill was a frustrated terrorism expert who felt his warnings about Osama bin Laden were ignored, and so left the FBI to become head of security at the World Trade Center shortly before the 2001 attack. He perished in the collapse.

tually all the most important policy debates in which he took part. Time and time again, his point of view on the most important questions of the day was overruled by political considerations, by economic ideology and by shortsighted politicians. This may not seem fortunate, but time and time again, events showed that he had been correct. He advised for stricter price controls during WWII, against the Bay of Pigs invasion of Cuba, against deepening involvement in Vietnam, for exerting more control over the excesses of our economy, and against relying on military spending to stimulate economic growth, and many more. In each case, we'd be living in a saner world had his advice been heeded, and though the nation didn't benefit from his contribution as much as he'd have liked, his reputation was burnished by each loss and subsequent vindication.

Richard Parker's new biography of Galbraith outlines each of these chapters in his life, along with the convergence of forces that made up the ultimately successful opposition(s). It's a fascinating study in might-have-beens, though one could weep for the sheer number of opportunities lost, such as his almost-successful attempt to dissuade Kennedy from sending significant numbers of troops to Vietnam. What we learn is that, far from being discredited by experience, most classically "liberal" economic policies were barely tried. Where they were instituted, they were quickly undercut by Republican cries of "communism." For example, Galbraith was an important part of the system of government price controls during WWII, but he lasted only about eighteen months in the post before Congress cut the office's budget and forced his resignation. He was replaced with someone much more pliable and far less committed to the goals of the program, which was itself soon buried. But the fact that prices rose during the war is now regularly cited as "proof" that the program didn't work.

Intellectual progress

Another lesson of Parker's biography is about the progress of, um, science. In the tales of jockeying for Harvard professorships, university benefactors aren't far in the background. That is, the field of economics is itself far from immune to power relations. Rich men and their foundations establish chairs in economics at universities, and finance research projects and books. Galbraith's own career was given an unlikely boost by Henry Luce, the rich publisher of *Time* and *Fortune* magazines, and Parker describes how the machinations of wealthy donors had a lot to do with which economists could claim the credential of Harvard professor and which cannot.

The process continues today. The Olin Foundation, for example, has a "Law and Economics" program, through which they have given tens of millions of dollars over the past two decades for the teaching of "free market economics" to economics departments at University of Chicago, Yale, Harvard, George Mason, University of Virginia, Johns Hopkins, New York University, Georgetown, Princeton, Stanford and MIT.[a]

Thus prepared, the voice of business conservatism was prepared to be influential when the moment arose. In the 1970's, the neo-classical economists were pretty much stumped by the facts on the ground: high unemployment *and* high inflation. The economics that emerged from that chaos with the most policy influence was monetarism, a mathematically sophisticated approach with an emphasis on free markets and low taxes, and a complete rejection of government spending as a tool of economic management. Is it only coincidence that this is the school of thought that best served the folks with money?

[a] From a report, "Buying a Movement," compiled in 1996 by People for the American Way.

Fighting economists By far the biggest battles Galbraith lost were with his professional colleagues in economics. Galbraith's career spans some important moments for the field: the rise of Keynes in the 1930's, the mathematization of economics throughout the post-war period, and the rise of monetarism and rebirth of neoclassicism in the last quarter-century. Parker, an Oxford-trained economist, has a lot to say about these battles, so we'll take them one at a time.

Galbraith cut his professional teeth at the start of the Depression. He completed his graduate studies in agricultural economics just in time to work for the new Roosevelt administration for a bit before taking an academic post at Harvard. The Great Depression put economists in a quandary. There wasn't an adequate theory to explain the persistently low levels of demand, and the equilibrating market models wouldn't explain how there could be such high levels of unemployment, either. The existing theories maintained that unemployment would be met by lowering wages until everyone was employed, but that simply wasn't happening. John Maynard Keynes came along and pointed out that low demand and high unemployment were obviously linked, and also that an economy could settle into a non-optimal equilibrium, which no one would have believed had it not been happening around them.

Keynes went on to suggest that government spending to raise aggregate demand would spur companies to hire people, and that there wasn't anything wrong with that in a time of high unemployment, even if it required the government to run a deficit.

Heresy like this was slow to catch on in government circles. That is, parts of it were thought acceptable—few industrialists complained when the government suggested increasing purchases of their goods—but parts of it would never have become policy had not World War II made many skeptics into believers by necessity.

Details, details During the 1930's and 1940's, Galbraith made two important contributions to what eventually became the dominant theory of modern economies. Or, well, he would have, had they been widely accepted by economists. His first important point was that "aggregate demand" is a messy and complex thing. Aggregate demand can go up while important economic sectors are still hurting if demand for those goods doesn't go up, too. Aggregate demand rose during the 1920's while farm prices fell, for example, and the same pattern has dominated the past two decades. It is therefore incorrect to claim that any action to increase aggregate demand is a good thing. Hurricane Katrina, for example, will likely increase aggregate demand in the US this fall, especially when reconstruction efforts begin.[4] This suggests that when demand falls again in a year or two, deliberately burning down Cleveland just might be the tonic our economy needs. But this has some shortcomings as official government policy.

Hurricane Katrina will boost aggregate demand and stimulate the economy. Shall we burn down Cleveland next?

What's more, there are many details within the structure of "aggregate demand" that a sane government should take into account. Is it wise policy for a government to encourage increased production of handguns? How about eggplant? Should we favor manufacturing stoves over disposable pie tins? How about jet airplanes over wheat? These questions sound arch, but stimulating the economy through fiscal policy involves making exactly such choices; if the government is going to buy stuff (and services) to create jobs, what should it buy?

Galbraith wanted this observation to be an occasion for debate about what kind of a society we want to have: do we want to be about making guns, or churning butter? Sadly, this didn't happen. After some inadequate attempts to put a Keynesian policy into place in the 1930's, World War II settled the issue, but not quite the way he'd hoped: deficit spending would be the rule of the day but the government would buy bombs. And planes and guns and all the rest of the military toys that eventually made the foundation of the "postwar" economy.

Another example of a misleading aggregate: employment over the past 30 years has shifted from high-skill high-wage manufacturing to low-skill low-wage service jobs. This shift is not well reflected in the widely reported statistics about unemployment, even though its implications are profound. If everyone is forced into a crappy job, why should we celebrate a low unemployment rate? But if the statistics in use don't reflect the important changes, then why do we care about those statistics? Is it only because they're the easy ones to measure?

Galbraith's second important contribution wasn't so much to economic theory as to its practical application. After Keynes's untimely death in 1946, few policymakers seemed to remember that his theory does not imply that public investment and deficit spending is *always* good. His theory holds that in times of high unemployment, almost any public spending that increases employment is a good thing, and that the funds spent have a return in tax collections that can far exceed the outlay. But it also implies that at times when unemployment isn't so high, the return is smaller, and so public spending may not make enough of a difference to be worth the cost of borrowing.[5] An example: building the Jamestown bridge in 1940, when the unemployment was around 15%[6] probably had a much greater effect on the Rhode Island economy than building its replacement in 1989, when the unemployment rate was closer to 6%.[7]

From 1946 on, in a nation made fat on nearly unlimited spending on bombs and planes, Galbraith was the uninvited guest at the banquet, reminding the guests that not all spending is justifiable as Keynesian stimulus. To this condition on the wisdom of deficit spending, Galbraith added the point that spending to increase productivity—real investment—is a better bet for deficit spending, since the spending is more likely to yield a dividend. As with many profound observations, this is essentially a common sense point. A government could engage in deficit spending by producing machine tools, or it could spend those borrowed dollars on kites to fly at the beach. One of these is more likely to create a country able to service the resulting debt, even if both would work to jump-start the economy in a time of high unemployment.

...Or should we rethink our reliance on aggregate statistics instead?

Making a plan One of the blessings of the 20th century is that a decent amount of military spending did turn out to be useful investment, after all. Demand for engineers incrased, and so did investment in the nation's universities. Demand for domestic suppliers of secret stuff, including machine tools and high-tech parts increased, and so did the sources of capital they could use to start up. The computer, too, is essentially a military invention, born of naval research to aim guns. Heaven knows

[4]Hurrican Andrew did just this in 1992. It may be that the vast increase in homelessness with Katrina or the damage to America's busiest port may offset the effect.

[5]See Keynes, *General Theory of Employment, Interest, and Money* (1936), Book III, Chapter 10, Section V, for part of his discussion.

[6]National. See *www.bls.gov/cps/cpsaat1.pdf*.

[7]Presumably the state had been wisely waiting for unemployment to rise again to Depression-era levels before tearing down the old bridge.

our nation wasted a tremendous amount of money on jet fuel, boot laces and matched racing yawls at the Naval Academy, but in among that dross was some investment that paid off in a big way. According to Galbraith, a sane policy would be to plan a little to increase the number of such happy accidents. Again, the category heading of "defense spending" lumps both the good and the bad together, and is an impediment to sensible policy.

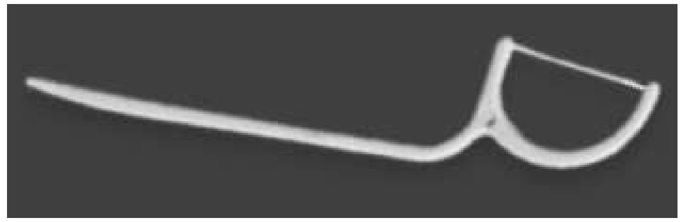
Which brings us to planning.

Planning happens. The question is only whether it happens on our behalf or only to benefit large companies.

Since the whole point of making plans is to make businesses do what they might not do otherwise, businessmen and their apologists have been whining about government planning since before the New Deal. Recently, presumably due to the fall of the Soviet Union, it's become easier to pass this point of view off as a popular one. But whether your political views require you to be against planning or not really doesn't matter at all, according to Galbraith. The reality is that planning happens. People with control over vast sectors of our economy do a tremendous amount of planning. Oil companies plan their drilling and refining schedules, car manufacturers plan their new models, power companies plan maintenance downtime for their generators. There are thousands upon thousands of executives in this country whose only task is to plan the futures of their corporations, and therefore of our lives.

But these are planners with only one goal in mind: improving the financial health of their corporation. By and large, they do not account for the health of their workforce, the health of the communities that support their factories or the health of the nation that made their companies possible and profitable. In essence, we delegate planning to those people whose professional regard of the common good is close to negligible. If through their disregard, a mess is made, well cleaning it up is what government is for.

The California electricity crisis of a few years back was a crisis in planning (whether deliberate or not remains a matter of controversy, but many Enron executives implied as much in emails and tapes played at Ken Lay's trial). Gas prices today are also a crisis in planning, with the same uncertainty over how much of the crisis is deliberate. The appalling declines in automobile gas mileage over the past two decades represents another crisis in planning.[8] The market triumphalism of the past decade has made it unfashionable to defend planning, but it was



government plans that all but eradicated polio and smallpox, and it is the marketplace that has given us disposable plastic dental floss holders, each one of which uses a few ounces of an irreplaceable natural resource for what, exactly?

Counting on economics Aside from Keynes, the other towering achievement of 20th century economics is the erection of a mathematical edifice that explains and justifies the important claims of the neo-classical economists. Economics involves money, and money involves counting, so no one ever really thought that you could make an adequate analysis of an economy without math, but the trend since the 1930's has been much more than this. Advanced training in economics now means advanced training in mathematics, because it isn't possible to understand most articles in the professional literature without deep background in statistics or in the peculiar varieties of math that mainstream economists use to construct their models of the world.

But, said Galbraith, these sophisticated models rely far too heavily on the aggregates he criticized, and he resisted them throughout his career. To him, the proper study of economists is not only the flow of money and goods in an economy, but also the power relations between the players. Without an accounting of these relations, mathematical sophistication is somewhat beside the point. He pointed out decades ago, for example, that large companies, through advertising and other kinds of marketing, have great influence over the desires of their customers. These companies have power over their customers not envisioned by economic theorists, but this is completely absent from the usual economic analysis of the market for sneakers, say.

Without an accounting of power relations in an economy, mathematical sophistication in economics is wasted.

No one has yet figured out a systematic and reliable description of how these kinds of power relations would affect the supply and demand curves, and the magical point at which they are said to intersect. But rather than discard the models as unrealistic, economists tend to describe considerations like these as simply beyond the purview of "modern" economics. They are "externalities." Sins of omission like these would be more forgivable if economists could do a better job of analyzing

[8] The crisis in New Orleans this month appears to be a crisis in government planning, but a second look shows it is, instead, the entirely predictable result of putting people who don't believe in the utility of government in charge of planning its functions.

our economy. Sadly, though, they are regularly baffled by events in the real world.

Bringing it home For Rhode Island,[9] some of the book's message is pretty clear: a great deal of what passes for economic development around here is either useless or a trap. State spending is regularly cited for its impact on the state economy. And it is true that such spending has a large impact. Each worker employed will spend their salary on housing, food, clothing and so on, and to the extent that other Rhode Islanders benefit from those expenditures, the original dollar spent is multiplied in its effect.

The problem is that unless the expenditure changes the productive nature of our state, you can't stop spending the money without laying off all those people. Looking at one of our highest-profile expenses, in practical terms we are committed to spending hundreds of millions each year on highways. Our state has a lot of people who work on construction contracts for DOT and have done so for years. But looking around the state, it's pretty easy to see construction that need never have been done. We have replaced bridges we ought to have fixed, we have four-lane highways in places that need much less, and we have country roads beset with expensive lighting and wide shoulders so that people can go very fast on them. None of these make our state a more productive place, even if one could imagine *some* road projects that do.[10] The trap is a political one: these projects employ enough people that calling an immediate halt to them would seem to be politically disastrous, even if using that same amount of money on the state's schools and universities would have many times the economic impact.

A second important lesson from Galbraith is that details matter. Rising employment levels are not as important as what's going on under the hood. Are the new jobs good ones? Are the people who take them able to earn a decent living safely? The gross numbers don't tell the important story. And the same can be said of rising housing prices, tax collections, and state personal income. The aggregate statistics so routinely used to predict and measure the ups and downs of the state economy are not nearly as important as the details of which they are composed.

Are the new jobs good ones? Details matter more than statistics.

Finally, there is an important critique of markets to take away from this book. Markets are an efficient way to allocate resources, but it is not necessarily true that efficiency is the highest good for a society. A free market in housing, for example, will always ensure that some people are priced out of that market. The free market in automobiles has brought us advertising picturing Chevy Suburbans rolling up green mountain fields, and it has also kept us dependent on oil, for better and, lately, worse.

Throughout his career, Galbraith never stopped pointing out the power relations between market players, the planning that shapes the markets, and the outcomes they produce: astonishing cars, but also air pollution beyond imagination; a phenomenal abundance of cheap food, but also impoverished farmers and destroyed cropland; widespread affluence but also dire poverty right next door. These are not immutable facts, he said, but the results of choices we've made. The questions he asked are ones we need to continue asking: As a society, is this what we want? Is this the best we can do? ■

[9] There had to be a reason to review this book, didn't there?

[10] The three biggest road projects pending or ahead of us—the Rt 195 relocation in Providence, the Rt. 403 highwayification in North Kingstown, and the new Sakonnet River Bridge—are all replacements for roads that already exist. Counting interest, these projects will ultimately cost over a billion dollars. Their net effect on productivity: zero.

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