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Have IRAs Increased U.S. Saving?

The Tax Reform Act of 1986 phases out the deductibility of contributions to Individual Retirement Accounts (IRAs) for higher-income persons—families earning more than \$40,000 per year—covered by company pension plans. An important argument favoring this change is that contributions to IRAs would have been saved anyway in some other forms if the IRA option did not exist. But a new study by NBER associates **Steven Venti** and **David Wise** finds that “the majority of Individual Retirement Account contributions represent new saving.”

Furthermore, they estimate that if the IRA limits had been increased as called for in the 1984 Treasury tax proposal, there would have been substantial increases in IRA saving. “If the IRA limit were raised, about two-thirds of the increase in IRA saving would be funded by a decrease in current consumption and about one-third by reduced taxes; only a very small proportion would come from other saving,” Venti and Wise conclude.

In **Have IRAs Increased U.S. Saving? Evidence from Consumer Expenditure Surveys** (*NBER Working Paper No. 2217*), Venti and Wise note that total IRA contributions have risen from \$28 billion in 1982 to about \$45 billion, roughly one-fourth of all personal saving in 1986. In 1983, 16 percent of U.S. households contributed to IRAs. Now about 20 percent contribute in a given year and possibly 30 percent have IRAs. Moreover, even though the percentage of contributing families rises with income—from about 4 percent of households with incomes under \$10,000 to about 58 percent of households with incomes over \$100,000—over 70 percent of all contributing families

have incomes of less than \$50,000 per year. Of individuals who contribute, 90 percent have incomes under \$50,000.

Venti and Wise find that the sharp increase in IRA contributions beginning in 1983 was not accompanied by a reduction in other forms of saving in financial assets. Moreover, financial asset balances in 1982 and 1983 were much lower than what would have been accumulated had saving in prior years been even a fraction of the typical IRA contribution.

“The vast majority of Individual Retirement Account contributions represent new saving.”

Families have a strong preference for IRAs that is independent of saving in other forms. Venti and Wise conclude that there is little substitution of IRA saving for other saving. They find that IRA saving in the post-1982 period, when IRAs became available to all employees, did not show up as non-IRA saving in the pre-1982 period.

Finally, Venti and Wise observe that contributors to IRAs are more likely to save in other forms than noncontributors do. While median financial assets per U.S. household in 1982-3 were \$1125, median financial assets were \$11,000 among IRA contributors versus \$812 for noncontributors.

International Competition in the Products of U.S. Basic Industries

In the last 15 years, U.S. basic industries—including steel, motor vehicles, textiles, and apparel—all have lost growing shares of their domestic markets to import competition. Employment has fallen and output growth has stagnated, leading to calls for increased trade protection to shelter U.S. producers from foreign competition. The U.S. steel industry is the most dramatic and chilling case: between 1979 and 1985, the number of wage employees there declined from 342,000 to 151,000, while the rate of return on stockholders' equity fell from 5.8 to -18.5 percent. Recent trends in the automobile, textile, and apparel industries, while somewhat less alarming, convey a similar impression of U.S. basic industries in steady and perhaps irreversible decline.

In a new study for the National Bureau of Economic Research (*Working Paper No. 2190*), Research Associate **Barry Eichengreen** finds that labor costs, productivity, and U.S. macroeconomic policy have conspired to bring about these problems for basic industries. However, Eichengreen believes that "U.S. producers will remain competitive wherever product quality and marketing are important. . . . Most of all," he concludes, "the competitiveness of U.S. basic industries will depend on their success in applying the new technologies developed in conjunction with the high-tech sector."

The recent difficulties of U.S. basic industries reflect both the efficient interplay of market forces (driven largely by economic development abroad) and inefficiencies resulting from labor, management, and government decisions that have proven ill-advised in light of subsequent events. Labor costs have been most important in steel and motor vehicles. For parts of the last decade, hourly earnings, even including fringes, have exceeded the average for U.S. manufacturing by as much as 65 percent in steel and 30 percent in motor vehicles. Trends in labor productivity have been insufficient to offset these high labor costs.

Macroeconomic policy in the 1980s has exacerbated the basic industries' problem of cost competitiveness. The 58 percent rise in the trade-weighted value of the dollar between 1980 and 1984 dramatically reduced the dollar value of the wages paid by foreign steel, textile, and automobile producers. Eichengreen estimates that the real appreciation of

the dollar between the second half of the 1970s and the first half of the 1980s reduced employment in motor vehicles and steel by nearly 10 percent.

Eichengreen predicts that the international product cycle will continue to operate. That is, developing countries, where labor and materials costs are low, should have a continuing if not an increasing comparative advantage in the production of standardized basic industry goods. But those U.S. industries that rely on skilled labor and proximity to the consumer—for example, the American automotive, steel, and apparel industries that produce relatively luxurious full-size cars, electrogalvanized steel, and designer clothing—have brighter prospects than the basic industries as a whole do.

"U.S. producers will remain competitive wherever product quality and marketing are important..."

The precise impact of foreign competition will depend on the stance of U.S. trade policies, Eichengreen continues. For the foreseeable future, trade in the products of these industries will be governed by "voluntary" restraints and bilateral quota agreements, as it has been in the recent past. If quotas are set at sufficiently restrictive levels, production for the U.S. market can take place domestically. But the costs of such policies are high. The competitive difficulties of the basic industries are the market's way of signaling that productivity there is relatively low. Permitting these industries to release resources, and even facilitating their smooth transfer through adjustment assistance programs, is a way of responding constructively to the productivity slowdown.

Moreover, robots, computer-controlled machine tools, and other forms of automated technology will continue to enhance U.S. productivity and quality control. These are the hope of the domestic industries for maintaining competitiveness as existing technologies continue to diffuse to newly industrializing countries.

If macroeconomic policies fail to prevent domestic demand from declining and the real exchange rate from rising as wildly as in recent years, Eichengreen believes, then the investment required for the adoption of these technologies will not take place. If domestic producers are provided overly generous protection, they will have little incentive to develop and adopt these new technologies.

Development Contrasts between Korea and Turkey

Korea and Turkey are two developing countries often mentioned in the context of their success in handling international debt. Korea has avoided a debt crisis altogether, and Turkey has managed to solve most of the problems that it encountered in the 1970s.

A recent study by NBER Research Associate **Anne Krueger** compares the experiences of these two countries since the 1950s and finds that much of Korea's success is the result of its efforts to solve fundamental economic problems, especially by providing incentives for exports. In contrast, Turkey adopted a policy of import substitution and generally responded with piecemeal solutions to the economic crises that it faced.

In **The Importance of Economic Policy in Development: Contrasts between Korea and Turkey** (*NBER Working Paper No. 2195*), Krueger describes the policies and progress of both countries from the 1950s to the early 1980s. Although Turkey and Korea had about the same population in the 1950s, Turkey was a much richer country. Turkish GNP was about three times as large as Korea's, Turkish exports were 15-times as high, and Turkey's saving rate was much higher than Korea's. By the 1980s, however, the situation was dramatically reversed. Turkish income was only 60 percent of Korea's, Turkish exports were one-fourth the size of Korean exports, and Turkey's saving rate was two-thirds of Korea's.

In the late 1950s, Korea's exports were only a small fraction of its imports, and the country was heavily dependent on American aid to pay for its imports. In anticipation of a cutback in aid, Korea decided to emphasize export-led growth as a long-term strategy.

Several steps were taken to implement this strategy. The exchange rate was devalued to increase the incentive to produce for foreign rather than for domestic markets, and measures were taken to ensure that exporters would receive an adequate real return despite domestic inflation. Although Korea continued to maintain tariff barriers against imports, exporters were allowed to import raw materials and intermediate goods duty-free, as long as these imports were re-exported within one year. In addition, the Korean government regulated interest rate ceilings and gave preferential treatment to exporters in the allocation of credit.

By contrast, the basic strategy of the Turkish government was to promote industry through import substitution. Although a balance-of-payments crisis in 1958 led Turkey to devalue its currency at about the same time as the Korean devaluation, Turkey adopted this policy in order to satisfy foreign creditors rather than to stimulate exports. Import controls were tightened or eased as foreign exchange became available. There was little effort to use import licenses or government subsidies to provide incentives for exports, and domestic producers of import-substituting products were protected from foreign competition by import prohibitions.

The Korean and Turkish responses to the 1973 oil price shock also were quite different, Krueger notes. Korea reacted by devaluing its exchange rate to stimulate exports, and by encouraging Korean firms to find new sources of foreign exchange—for instance, from construction activities in the Middle East. In addition, domestic energy prices promptly were raised, with some adjustments in tax rates to offset the impact on low-income groups.

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Once again, Turkey responded slowly and inefficiently. The real exchange rate was allowed to appreciate and the domestic price of energy was restrained. Because no serious effort was made to adjust to increased oil prices, Turkey's current account balance deteriorated sharply and economic growth declined.

Krueger also notes that Korea's income distribution was relatively egalitarian at the end of the 1950s and became more so as development proceeded. On the other hand, Turkey's income distribution differed from Korea's in the 1950s and deviated even more over time. In the mid-1970s the top 20 percent of Korean households had average incomes that were eight times as high as the average income for the poorest 20 percent of the population. In Turkey, the top 20 percent received 16 times the income of the bottom 20 percent.

Krueger concludes that Korea's strategy of export-led growth and, more fundamentally, the willingness to confront economic problems and seek solutions explain much of Korea's rapid growth since

1960. Turkey's policy of import substitution and simply getting through crises was less successful. This is indicated by the substantial difference in the two countries' growth rates. Between 1960 and 1984, real GNP increased sixfold in Korea, while Turkish GNP rose by a factor of 3.4. Per capita GNP nearly quadrupled in Korea, while it just doubled in Turkey over this 24-year period. Only after Turkey's economic reforms in 1979—moving toward a stronger export orientation—did the performance of the Turkish economy improve.

Erratum

In the March 1987 *NBER Digest*, "State and Local Capital and Investment," which describes the results of NBER Working Paper No. 2131 by Michael J. Boskin, Marc Robinson, and Alan Huber, misstated their estimates of the net capital stock for 1981-5. The correct statement, which appears on page 10 of their paper, is that for 1985, the authors' estimate is 17 percent higher than the corresponding net capital stock estimate of the BEA.

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