Policy Perspectives

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Policy Issues

Rise of household debt

- Is it a problem? Good: improved functioning of financial system; Bad: Overleveraged economy; Bankruptcy rise; ability of elderly to manage
  - Macro. Debt everywhere all the time. Govts, businesses, households
    - How much secular v cyclical?
    - Balloon theory
  - Composition of debtors: income (low), wealth (low), age (young?), cohort, gender, ethnicity
  - Composition of debt: house, student, credit card
  - Causal connections?
    - Sea change: rising house prices, falling wages or cohort effect: debt is less onerous
    - Debt causes work; work causes debt
    - Generational divide
- How much is the debt issue a byproduct of other policy issues and solutions?
  - Homeownership is good
  - Recall shift in homeownership patterns. Before 1930s, retire and rent. No 30-yr mortgage. Reverse mortgages. Note role of government
  - Today, think student loans: lower income, lower wealth, younger.

Policy considerations

- Education
  - General financial literacy
  - Specific education/training re debt
- Policies for specific types of debt
  - Role of housing
  - Student loans
    - Cost of education
    - Disclosure, guidance and protections
  - Credit card
    - Disclosure, guidance and protections
- Overall
  - Effective financial regulation: CFPB (BCFP?)
  - Macroprudential policies

Policy Perspectives on Debt at Older Ages

- 3 diverse papers. 2 talk about debt (US and World) and the other talks about the need for saving among the poor (US)

- Debt
  – Incidence and value of HH debt is rising and (less clearly) across the income/wealth spectrum.
  – Those with higher debt work longer (US); particularly sensitive to $ changes in credit card debt
  – Student debt is a higher % among lower wealth HH and has a larger effect there
  – At the macro level (world), increases in debt/GDP ratio are positive in short run, negative at 3-5 years (esp for bank stocks and prob of crisis), but can be mitigated by good reg and other public policies and lower income inequality.

- Issues and Questions
  – It is important, but maybe impossible, to understand what's driving working longer. Maybe look at some measure of debt surprises—2008-9 is a natural experiment. Also draw out public policy implications. Should we encourage debt if it makes people work longer?
  – For macro effects, would we prefer a HH debt increase compare to a govt debt increase?

Policy Perspectives on Debt at Older Ages

- Saving
  - By looking at a different, arguably more accurate, way to measure income, SS can replace a very high % of income for low-income workers
  - Therefore, many low income workers do not need to save outside of SS
  - One lesson is that, like savings, rising debt, and certain types of debt, may be an issue for some groups and not others. Not necessarily monotonically associated with age or income.

- Issues and Questions
  - What's the right way to measure SS wages?
  - Low-income workers are more likely to have income variability/interruptions than higher-income workers? How much effect does this have on replacement rates?
  - Low-income retirees less likely to purchase supplemental health insurance coverage and to suffer from higher morbidity. However, more likely to have access to nursing care (Medicaid)
  - What about rising debt among low-income workers?

Butrica and Karamcheva

Is Rising Household Debt Affecting Retirement Decisions?

- Analysis of SCF (w/HRS comparisons)
  - Incidence and value of debt has grown: e.g., total avg Debt/Assets (12% to 26%) and Debt/Income (57% to 98%); younger cohort analysis suggests this could continue (age, cohort, event)
  - % households w/negative net worth has grown (negative home eq & student debt), but still small
  - Households slower to pay off mortgages (69% of all debt) than their predecessors
  - Presence of debt leads to (actual and expected) working longer (≈10% points more likely to work), but amount of debt isn't much of a driver
  - Working longer is more sensitive to change in $ of credit card debt than of mortgage debt—could we understand this better if we looked at monthly payments rather than size of debt?
  - Some improvement recently: trend or blip?

Butrica and Karamcheva

Is Rising Household Debt Affecting Retirement Decisions?

- Scary bits about student debt
  - Student debt increased more than other debt (from 3% to 10% of households; $5400 to $18,000)
  - Increase in student debt is among the lower 2/3 of older households by wealth (12% v. 6%);
  - For lower 2/3 with positive wealth, ≥ credit card debt;
  - For those with negative wealth, 47% of total debt
  - Change in student debt has a stronger effect on propensity to work and to take SS among lower wealth households compared to higher wealth households
  - ½ of student debt is for children
- Implications
  - More debt in retirement could exacerbate impact of any negative financial shock

Butricia and Karamcheva

Questions

- Debt figures?

	2016 Debt	
	Total	Mortgage
Mean	≈$125,000	≈$140,000
Median	≈$60,000	≈$95,000
Share	≈7.5%	≈4.5%

- Endogeneity. They discuss this and suggest using attitudinal responses
  - Reverse causality: more debt causes longer work.
  - Other variables: e.g., risk aversion causes debt and work

Biggs

Is There a Retirement Crisis Among Low Earners?

- Replacement rates are high and poverty has declined
- Test "cases" based on
  - 5s
    - Income types,
    - Target replacement rates (RR target inversely related to income),
    - Longevities at age 66 (plus cases with longevity + 20%)
  - 35 years of saving: 8.7% v. 7% nominal portfolio returns (preretirement)
  - 0.8% v. 2.3% real returns (post-retirement)

Biggs

Is there a retirement crisis among low earners?

- Results
  - Shows us 5 required savings rates varying from 0.4% of income to 8.5% of income depending on the test "case"
  - Not very sensitive to changes in returns or mortality
- Implications
  - SS replacement rates higher than commonly believed
  - Very low-income workers don't need to save beyond SS
  - Lower income should save modestly and higher income a little more, but less than thought previously
  - State auto-IRAs could help, but high auto escalation features not needed

Biggs

Is there a retirement crisis among low earners?

Implications

- Addresses an under evaluated issue
- Findings hinge on the way we understand SS replacement rates:
    - SS replaces about 90% of the first $885 of wage-indexed AME (lower for higher earnings), but Biggs points out we should be using inflation-indexed AME, which would suggest that SS replaces 90% of the first $1133 AME.
    - This means that anyone earning poverty wages (about $12K/yr) could replace 90% with SS. At 150 of poverty earnings, the SS RR is 76%.
    - Put another way, a worker earning 25% of national wage avg would receive an amount equivalent to saving 22% of lifetime earnings.

Alter, Feng and Valckx

Understanding the Macro-Financial Effects of Household Debt

- Findings based on analysis of debt changes and GDP growth across emerging and developed countries
  - Effect of changes in HH debt on GDP growth positive in very short run; negative in 3-5 years
  - Effect of HH debt increase more likely to be positive if: Better regulation; less external financing; flexible exchange rates; lower income inequality
  - Higher participation by low-income households in mortgage market reduces negative effects of HH debt increase.
  - HH debt ratio increases negative for future bank stock returns and increases likelihood of banking crises
  - High household leverage reduces consumption

- Likelihood of financial hardship for near retirees in US is higher than for earlier cohort
  - Some things are good: higher female labor force participation
  - Some bad: more debt and more debt/assets
  - Measures: poverty, Medicaid, food stamps, annuitized wealth all up for my cohort
- Japan comparison
  - G7 Canada, UK have more debt, Italy less, Japan and US in the middle
  - Decline in overall Japan debt levels since 2000
  - Age 50-59 Debt/Income has been pretty steady after 1985. proportion holding debt steady (75%)
  - Contrast to US
  - But, cohorts after 1961 have higher housing debt and are used to very low interest rates
- Questions: race and ethnicity and mortality diffs between cohorts; working longer?;
- Why does debt matter? Housing is different from other forms of wealth (wealth+consumption+insurance policy); inelastic demand for homeownership, but we do see lower homeownership by younger cohorts, esp in bottom half of income

Lusardi

National Financial Capability Study 2015

- Lower income people have more student loan debt (% of income?) and about the same credit card interest payments and more credit card fees
- Survey
  - 33% of people age 56-61 say they can't come up with $2000 in 30 days
  - 36% say they have too much debt
  - 45% say they are unable to make ends meet easily
  - Financial literacy is low, esp among financially vulnerable
  - Results are heterogeneous: gender, income, ethnic minorities, marital status etc., type of debt
  - People are unaware of credit scores, loan repayment options, pricing options
  - Lots of behavioral biases

- Policy Implications
  - Certain groups feel/are more vulnerable
  - Literacy and biases magnify/add to vulnerability

Lester, JP Morgan

Paying it Back

- Out of 31 million households, they have about 5 million that spent a significant portion of their income through Chase. Compared to national data, student loans and auto loans are a little lower and mortgages are much higher.
- Cross sectional data so it is hard to know whether age diffs are cohort effects
- Wealthier folks have lower debt service payments as a % of wealth