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In this issue

- Privacy Standards
- Forty Years of Poverty
- Mandatory Retirement Ages
- Economic Outlook

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U.S. Privacy Standards: Facing the Impact of Foreign and International Data Transfer Rules

by Gregory Shaffer

Gregory Shaffer is assistant professor of law at the University of Wisconsin–Madison. His paper was presented at a conference at the La Follette Institute, “The Structure and Organization of Government,” held in Madison, April 22–24, 1999. This article is derived from a complete version of the paper appearing in The Yale Journal of International Law, Volume 25, and is printed with their permission. © 1999 The Yale Journal of International Law. All rights reserved.

Almost daily we are subject to phone calls, mail, or electronic communications from organizations trying to sell us services or solicit our money. How do they get our numbers? Learn our habits? Who is compiling, selling, and swapping information about us? It has been estimated that, on average, companies trade and transfer personal information about every U.S. resident every five seconds. How may we review and control its use when technological advances permit rapid, low-cost compilation, storage, and transfer of personal data?

Much of the compiling and transfer of personal information, which is a daily occurrence in the United States, is illegal in Europe. On October 24, 1998, the European Union (EU) Directive 95/46/EC on the Protection of Individuals with Regard to the Processing of Personal Data and the Free Movement of such Data became effective. The directive mandates significant regulatory controls over business processing and use of personal data and provides that the European Commission may ban data transfers to third countries that do not ensure “an adequate level of protection” of data privacy rights. Since it appeared that the United States might not provide for “adequate” data privacy

protection under the directive’s criteria, U.S. and EU authorities have engaged in intensive negotiations to avoid a ban on data flows. In the meantime, U.S. businesses have started to take data privacy claims more seriously.

This article examines the ongoing dispute between the United States and the EU over the regulation of data privacy protection from the perspectives of transnational regulatory conflict and interdependence. It assesses the impact of this conflict and interdependence on the behavior of private parties—particularly U.S. businesses doing business in or with Europe. In an age of economic globalization, while many are concerned that national standards will be lowered to stimulate national competitiveness, this article assesses the conditions under which cross-border economic exchange can help leverage standards upward, even in a powerful country such as the United States.

The Directive’s Key Requirements

The EU’s directive takes primarily a legislative approach to data privacy protection and is noteworthy for its broad scope of coverage. Except for public security, criminal law, and related exceptions, it covers all processing of all personal data



Director's Perspective

The increasingly international focus of the La Follette Institute is clear in this issue of the *La Follette Policy Report*—our last issue of the twentieth century. In the center of the issue, we announce our new international master's degree program, a program that promises broader attention to global concerns in our curricula and all of our programs. To begin the program in the fall of 2000, we are attracting new students, faculty, and staff and will effectively double in size. For more detailed information on the new degree program and on our hiring initiatives, see our web site.

With world trade, world trade rules, and the World Trade Organization in the news, our lead article is especially apropos. Greg Shaffer, a law professor on our campus, specializes in privacy issues and explains the global implications of countries setting privacy standards and how such standards affect world trade. His writing stimulates the kind of debate that this issue deserves.

One of our most prolific faculty members, Robert Haveman, has another article in this issue—a series of reflections on the last forty years regarding poverty issues. He outlines who, in an aggregate sense, the “winners” were—the elderly and intact minority families—and who were the “losers”—single-mother families, children, and poorly educated minority youth. He urges, among other things, that institutions be strengthened so those at the bottom of the income distribution can be cushioned against a reverse in the fortunes of the current economy.

Karen Holden and Lee Hansen, economists who have studied retirement issues, have in this Policy Report revisited the mandatory retirement issue that has faced higher education in particular

for the last decade. They studied the effects of “uncapping” mandatory retirement and concluded, among other things, that major changes in pension plans are not necessary. Universities, rather, should promote “development of options that allow faculty to move into part-time assignments that permit them to continue their research and in some cases limited teaching activity.” This article will prove interesting to faculty and administrators at public and private institutions alike who are concerned with the “graying of the faculty.”

Don Nichols, our resident crystal-ball-gazer, includes here his latest economic forecast. Nichols has a stellar reputation as a forecaster, so we put credence in what he says about the future of our economy. In short, he expects a bit higher inflation in this next year, an accompanying increase in interest rates, and a continuation of recent economic trends. Regarding Y2K problems, he quotes from Alan Greenspan, who recently invoked the comic strip character Pogo of old: “We have nothing to fear but fear itself.”

As this issue of the *La Follette Policy Report* goes to the printer, we are beginning to compile the proceedings from our recent Living Wage Symposium. The conference was held primarily in response to student concerns over working conditions and wages of workers in places where university logo apparel is made. The three-day conference attracted participants from throughout the country to discuss the possibilities and constraints related to determining, setting, and monitoring a living wage. Watch for a full report of the Living Wage Symposium in our next issue.

John F. Witte

by whatever means, and is not limited to action by government, business sector, or field of use. It prohibits data controllers from processing information unless the individual “unambiguously” consents to the processing and that consent is informed. Information subject to the most stringent controls includes “personal data revealing racial or ethnic origin, political opinions, religious or philosophical beliefs, trade-union membership, and the processing of data concerning health or sex life.”

The directive provides multiple means for enforcement. It grants individuals a permanent right of access to obtain copies of the data about them and have it corrected or its use enjoined. It requires member states to provide a judicial remedy for infringements of data privacy rights, including the right to receive damages. To support effective enforcement, member states must designate an independent public authority “responsible for monitoring the application within its territory” of the directive’s provisions. These supervisory authorities are granted significant powers, including the power to investigate processing operations, to deliver “opinions before processing operations are carried out,” to order “the blocking, erasure or destruction of data,” to impose “a temporary or definitive ban on processing,” and “to engage in legal proceedings.”

Privacy Protection in the U.S.

Unlike the broad scope of coverage and centralized standard-setting and enforcement features of the EU directive, data privacy regulation in the United States is fragmented, ad hoc, and narrowly targeted to cover specific sectors and concerns. It involves standard setting and enforcement by a wide variety of actors, including federal and state legislatures, agencies and courts, industry associations, individual companies, and market forces. To a certain extent, the U. S. handling of data privacy issues reflects Americans’ traditional distrust of a centralized government. U.S. legislation provides citizens with significantly greater protection against the collection and use of personal information by government, in particular the federal government, than by the private sector.

Data Processing by Government

The Privacy Act of 1974 is the only federal omnibus act that protects informational



privacy. Yet despite the legislation's broad title, the Privacy Act applies only to data processing conducted by the federal government, not by state governments or the private sector. The Privacy Act obliges federal agencies to collect information to the greatest extent possible directly from the concerned individuals, to retain only relevant and necessary information, to maintain adequate and complete records, to provide individuals with a right of access to review and to have their records corrected, and to establish safeguards to ensure the security of the information. The Privacy Act also requires federal agencies to designate a "Privacy Act official" to oversee the agency's compliance with the law's requirements, as well as "Data Integrity Boards" to review interagency data matching activities.

The Privacy Act does not apply to the states, the vast majority of which lack omnibus privacy acts. States, rather, offer scattered statutes applying to specific sectors or concerns, such as the regulation of access to educational records and child abuse data banks. Except for certain issue-specific legislation that is federally mandated, there is little uniformity of state law where it exists. While provisions of the U.S. Constitution have been held to offer some privacy guarantees against actions of state and federal government officials, the coverage is quite limited and, once more, applies only to government action, not private action.

Data Processing by the Private Sector

Congress has limited federal privacy protection to discrete sectors and concerns, as depicted in the following statutory titles: the Driver's Privacy Protection Act of 1994, Video Privacy Protection Act of 1988, Electronic Communications Privacy Act of 1986, Cable Communications Policy Act of 1984, and the Fair Credit Reporting Act of 1971. Rather than engage in a concerted effort to protect individual privacy, in many cases Congress has simply reacted to public scandals. In passing the Fair Credit Reporting Act, Congress responded to reports of abuses by credit reporting agencies. Congress enacted the Video Privacy Protection Act after the video rental records of Judge Robert Bork were obtained and published by a news reporter in the course of a campaign against his Supreme Court nomination. As a result, in the United States, video

rentals have more federal protection than do medical records.

While U.S. data privacy protection may be adequate according to EU standards in some sectors, it was thought by the Europeans to be inadequate in most. Individuals have little or no privacy protection in unregulated sectors. In these sectors, businesses are not required to obtain an individual's consent to the processing, marketing, or sale to third parties of personal information. Moreover, individuals have no access to processed information and cannot challenge its accuracy or use before a court or administrative body.

Congress has, in particular, kept its hands off the powerful direct marketing industry. As a result, enterprises can freely compile, mix, match, buy, sell, and trade profiles covering an individual's purchasing proclivities, physical, emotional, and mental conditions, ethnic identity, political opinions, and moral views. As one direct marketer boasts, its profiles "make it easy to keep up with the Joneses, as well as the Johnsons, the Francos, the Garcias, the Wongs and all the others." The attitude of many U.S. businesses is encapsulated in recent remarks of the president of Sun Microsystems: "You already have zero privacy—get over it."

Even where information is covered by U.S. legislation, no central administrative agency monitors compliance. In the United States, a hodgepodge of federal agencies oversee privacy issues—agencies such as the Federal Trade Commission, the Office of Consumer Affairs, Office of Management and Budget, Comptroller of the Currency, Social Security Administration, Department of Health and Human Services, Internal Revenue Service, Federal Reserve Board, and the National Telecommunications and Information Administration. To date, these agencies do not coordinate their data privacy oversight.

Advocates of the use of market mechanisms maintain that the private sector operates most efficiently when government regulation does not constrain entrepreneurial activity. At first glance, this maxim seems to apply to the gathering and compilation of information, as attested by the success of the data marketing industry in the United States compared to its counterparts in Europe. In the United States, even the FBI seeks information for its investigations from private companies.

Because of Americans' ad hoc approach to data privacy, U.S. regulation of the private sector largely depends on industry norms and individual company policies, which are developed in reaction to market pressures. Yet until recently, industry norms and policies were rare. While they have suddenly proliferated in the context of U.S.–EU negotiations over the adequacy of U.S. data privacy protections, these "self-regulatory" schemes remain voluntary, unenforceable, and, it appears, often ignored by the very companies advocating their use. The Better Business Bureau and a group named TRUSTe have created privacy seals in order for companies to market their data privacy practices to attract customers and fend off legislation, but there is so far little to no external monitoring of labeling practices. While privacy advocates assert that these "self-regulatory" measures are smoke screens to impede government regulation, they nonetheless hope to use the directive's regulatory mechanisms (and U.S.–EU negotiations over their application) to change regulatory policies and market practices in the United States. The timing of the sudden proliferation of self-regulatory schemes suggests that the directive provides privacy advocates with significant leverage.

The Role of Alternative Institutions in the United States

Alternative institutions can regulate the commercial use of personal information. Government regulation, whether federal, state, or local, is only one means of regulating firm behavior. Even in unregulated sectors, and even where courts do not recognize common law or constitutional rights of action, market forces can still constrain company behavior. Common law courts can also intervene to protect individual privacy interests from tortious acts. The Supreme Court could, in theory, also read constitutional provisions broadly to better protect individual informational privacy.

Role of Markets

Markets can be powerful regulators. Companies value their reputations. Trade-names and trademarks not only facilitate product promotions, they facilitate boycotts. A company's reputation in the market can thereby constrain its use and transfer of information about its clients. Major U.S. companies have implemented



data protection policies either in response to negative publicity or to reduce its risk. Pacific Bell and America Online, two huge telecommunications companies, abandoned plans to sell information on their subscribers in response to widespread customer complaints, and instead developed new company data privacy policies. Bowing to consumer protests, Lotus Development Corporation, the large software company, and Equifax, the large credit bureau, abandoned plans to create a CD-ROM containing household information that would be valuable for marketing. Equifax reputedly ceased marketing consumer names and addresses altogether, even though it had earned \$11 million in revenue from such sales the previous year. Intel likewise reversed its decision to activate an identifying code number in its next generation of computer chips, Pentium III, which would enable companies to gather profiles of individual users of Web sites. It did so just hours after a consumer rights group (the Electronic Privacy Information Center) called for a boycott of the chip. These companies did not react to lawsuits or government threats; they merely attempted to preserve their market image.

A number of U.S. commentators and policymakers advocate a contractual approach to data privacy. Under a contractual model, individuals can simply pay for privacy protection or threaten to take their business elsewhere. Proponents of contractual models claim that they are economically more efficient than government regulation.

These commentators also advocate greater consumer education to enhance consumers' bargaining positions. One advocate of a market-based approach proclaimed, "The answer to the whole privacy question is more knowledge. More knowledge about who's watching you. More knowledge about the information that flows between us—particularly the meta information about who knows what and where it's going." The National Consumers League and others have designed projects to so educate consumers. As Indiana University Law Professor Fred Cate notes, consumers can learn to check help screens and instruction manuals, and, in general, develop a greater awareness of privacy issues, including their right to "opt out" of having their personal information used for other purposes. In this way, market advocates argue, consumers

may enforce privacy rights through contract (explicit or implicit) and threatened exit from contract.

Private contract and market models, however, offer no panacea. Markets (no surprise) are imperfect; knowledge is expensive; parties have unequal access to information. The market for data privacy protection is characterized by widely dispersed individuals, with low stakes, entering into ad hoc transactions with large enterprises. Data processors and business leaders know how they will exploit personal information; individuals do not. Business enterprises repeatedly use individual information; individuals only intermittently are aware of privacy intrusions. Individuals have highly imperfect information, which they improve upon only at considerable cost. To investigate the privacy practices of every business with which one contracts for a product or service costs time and money. Individuals thus forgo investigating enterprise behavior and forget contracting.

Much of the compiling and transfer of personal information, which is a daily occurrence in the United States, is illegal in Europe.

Role of Legislation

The market is not solely an alternative to legislation and judicial intervention. It is also a complement. Legislation creates default rules around which bargaining can take place. There are, however, powerful forces impeding legislative change—a problem that parallels those encountered with market mechanisms.

The market for regulation encounters the same characteristics of well-financed groups with clearly defined, high stakes. Businesses are simply more active and effective players than are dispersed consumers with less clearly defined, low stakes. Businesses better promote their interests before Congress and administrative bodies than do individual consumers.

When the Department of Commerce asks for comments on draft privacy guidelines, comments stream in from large multinational corporations and business associations. As a result of successful industry lobbying, industry remains the dominant regulator of information privacy standards in the United States.

Individuals have lower stakes because they do not know when, how, or if the multitude of transactions in which they engage could result in severe harm, whether through refusal of insurance coverage, job dismissal, identity theft, or reputational injury. Moreover, while privacy advocates cite polls showing that 80 percent of Americans believe they have "lost all control over how personal information about them is circulated and used by companies," many Americans are ambivalent about privacy. For example, the popular daytime shows of Jerry Springer, Oprah Winfrey, Sally, Ricky et al. feed off self-exposure and voyeurism. Even individuals who desire to protect their own privacy may covet intruding on the privacy of others.

Role of Courts

Privacy advocates also stress the need for courts to protect individual data privacy rights. Some privacy advocates call for courts to expand tort law and independently recognize a cause of action for tortious commercial sale or use of private facts. Other privacy advocates call for legal recognition of property rights in personal information. Common law courts would thus have to balance individual privacy interests against the public and private benefits arising from unhindered information flows. Yet others demand that Congress create new rights of action by passing an omnibus data privacy statute (analogous to the EU's directive) under which courts and administrative bodies could enjoin company practices, fine companies, and award damages for violations of individual privacy rights.

Yet there are also limits to relying on courts. Application of a balancing test in a tort or property case would be time-consuming and expensive, using up limited judicial resources. Moreover, given the infinite number of transactions in which data privacy concerns arise, courts could not possibly handle all disputes even if individuals were to have the time and

continued on page 14



The Poverty Problem After a Forty-Year War: Reflections and a Look to the Future

By Robert Haveman

This is a shortened version of a paper prepared for a Yale University–Brookings Institution conference, “Economic Events, Ideas, and Policies: The 1960s and After,” held November 12-13, 1999. A complete version of the paper is forthcoming in a conference volume to be published by the Brookings Institution. Robert Haveman is John Bascom Professor of Economics and Public Affairs at the University of Wisconsin–Madison.

My, how things change! In the mid-1960s, America was experiencing a period of sustained economic growth, rising real wages, and low unemployment; the fruits of the prosperity were widely visible. It was after the Korean War, and before the Vietnam War had heated up. One of the nation’s primary public policy issues was “poverty,” and numerous pieces of legislation backed by appropriations were making their way through Congress and onto the president’s desk.

Today, near the beginning of a new millennium, the nation is again experiencing a period of sustained prosperity. Unlike the mid-1960s, however, easing capital gains taxation and the marriage penalty, granting broad-based tax relief, enforcing work for low-income benefit recipients, and ensuring that social insurance and medical benefits for the older population are maintained occupy center stage. The nation’s poverty problem is off the table, and economic inequality seems of little concern, in spite of its dramatic increase.

The Trends in Poverty

The nation’s declaration of a “War on Poverty” in 1965 came during a long period of postwar economic growth, with rising productivity and wages, and declining inequality. As figure 1 shows, in the years preceding announcement of the War on Poverty, the poverty rate had been falling consistent with this growth and prosperity.

The War on Poverty initiative started fast and it had an effect. The poverty rate fell from 17.3 percent to 11.1 percent between the 1965 declaration of the War on Poverty and 1973. Since 1973, however, the nation’s poverty rate has never again reached this low level. By 1975 the poverty rate had increased to 12.3 percent, and then hovered around 11.5 percent during the late 1970s, as real wage and productivity growth virtually came to a halt after the oil crises. In the early 1980s the most severe recession since the 1930s occurred, and the poverty rate rose to 15.2 percent.

Following the recession of the early 1980s, employment rose and civilian unemployment fell (from 9.7 percent in 1982 to 5.5 percent in 1990). However, low- and medium-skilled males’ real wages continued the erosion that had begun in the mid-1970s. In 1985, the inflation-adjusted income of the typical full-time male worker was below the level it had been in 1970. Among educated and skilled workers, wage rates and earnings grew rapidly, resulting in an increase in earnings inequality.

While the poverty rate edged down following the recession, it stood at more than 13 percent when the recession of the early 1990s set in. The poverty rate rose, again approaching the 15 percent mark in 1993. Between 1973 and 1992, the number of people officially classified as poor increased from 23 million to 37 million persons. During the prolonged economic expansion following 1992, the poverty rate drifted down steadily, and stood at 13 percent in 1997, the last year for which data are available.

The persistence of poverty since the early 1970s camouflages substantial changes in the composition of poverty over the period.

Winners and Losers

Poverty has declined for two groups: the elderly and intact minority families (see table 1 on page 6). The exit of the elderly and intact minority families from the bottom tail of the income distribution left a vacuum that has been filled by other groups. These “new poor” are composed primarily of mother-only families, children, and youth (especially minority young men).

The Elderly

The economic plight of the elderly in the 1960s was an important catalyst for the War on Poverty effort. Because of low earnings during working years, negligible accumulated savings, virtually nonexistent private pension plans for low wage workers, and a Social Security system that was far from universal in its coverage of

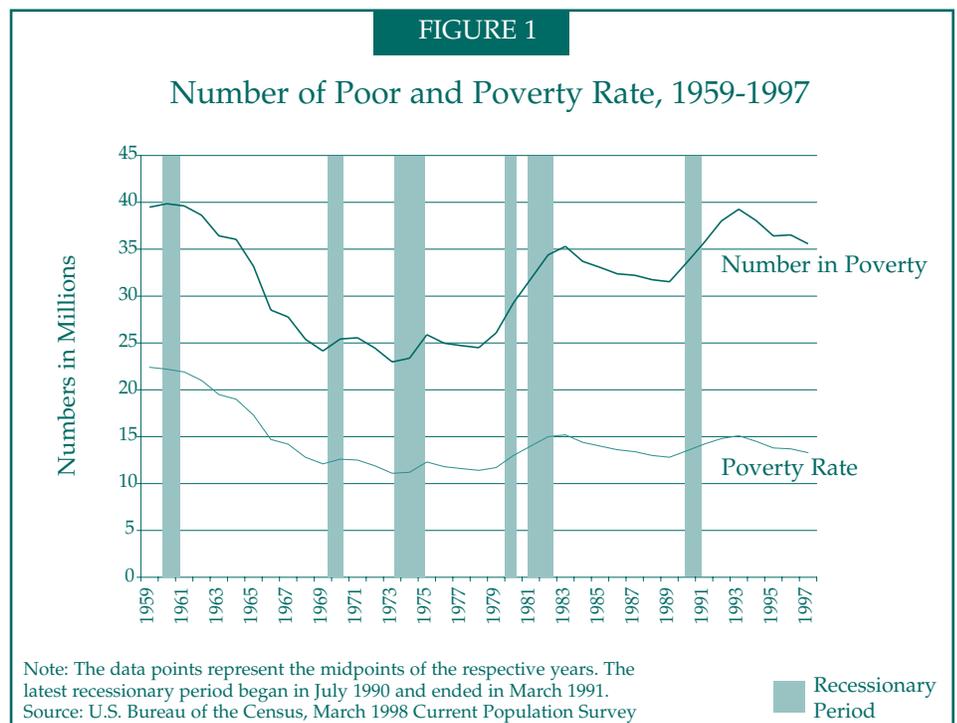




TABLE 1

Economic Status of Various Groups, 1959–1997

Poverty Rates	1959	1967	1970	1980	1990	1997
Elderly	35.2	29.5	24.6	15.7	13.0	10.5
African American intact families	n/a	31.3	n/a	15.5	14.3	9.0
Mother-only families with children	59.9	44.5	43.8	42.9	44.5	41.0
Children	27.3	16.6	15.1	18.3	20.6	19.9

Source: U.S. Bureau of the Census

new retirees, the elderly of the 1960s had low incomes and very high poverty rates.

By the mid-1980s this was no longer the case; indeed, average Social Security benefits of a retired worker grew from about \$420 per month in 1970 to about \$722 per month in 1984 (in 1997 dollars). By then the poverty rate of elderly people had fallen below the national rate and has remained there. In 1997 the poverty rate of the elderly stood at about 10.5 percent. Although some elderly (e.g., nonwhite older people and widows) still record higher rates than the national average, no longer are the elderly considered to be one of the nation's vulnerable or insecure population groups. These gains in the economic status of the elderly can be attributed to the deliberate and rapid increases in public benefits targeted toward older people.

Intact Minority Families

While the levels of insecurity and poverty remain far higher for African Americans and Hispanics than for whites, there is a striking—though often-overlooked—success story for racial minorities, especially those living in intact families. Take African Americans for example: While they still earn less than whites in comparable positions, the gap between them has narrowed considerably. While the median African American male, full-time, full-year worker earned only about 60–62 percent that did the average white male worker in 1960, today the figure stands at about 74 percent (the gain is also dramatic for females).

These earnings gains have carried over to the income levels of families, in particular intact families with two potential earners. In 1960 average income for African American two-parent families stood at 64 percent of that of white intact families; today it is nearly 80 percent.

From 1967 to 1980, the poverty rate for intact African American families with children fell from over 30 percent to about one-half of this level; by 1997 the poverty rate for these families stood at less than 10 percent, a figure that is below the overall national poverty rate.

Among the several factors that have contributed to these gains, the decreasing gaps in schooling attainment and in the quality of the schooling appear to be among the most important. A second important factor in explaining this gain is the strong economic growth from the start of the 1960s to the late 1970s. Although racial minorities have historically been on the fringe of the labor market, this period was a relatively good one for them. Progress faltered after the late 1970s, but the record of the 1960s and 1970s stands as a period of solid gains for racial minorities with a high school diploma or some college.

Disparities in regional growth, and the willingness of racial minorities to respond to them, have also played an important role in the gains experienced by African Americans. During the 1950–1970 period, northern states and their large cities tended to have stronger economies, more rapid growth, and smaller racial earnings differences, and many African Americans (and Hispanics) migrated to them.

Families Headed by Single Mothers

Families headed by single mothers form the most rapidly growing group living in poverty. By 1996 persons living in mother-only families constituted over 42 percent of non-elderly poor people, even though they are only about 15 percent of the nation's population. Indeed, today more than one-half of all poor families are headed by a single parent, nearly always a woman.

Several factors explain the increase in the share of the poor that is accounted for by these families. The most important reason is the rapid increase in the number of mother-only families over the past few decades, in line with the increase in both divorce rates and the rate of out-of-wedlock childbearing.

With few exceptions, a mother-only family has but one potential wage earner—whose earnings are no more than one-half that of a similar intact family. Moreover, single mothers are burdened by child care responsibilities. When child care costs are subtracted from the earnings of single mothers with low education and few skills, there is little left for other necessary expenditures.

The erosion of the public safety net after the mid-1970s is the primary cause of the increased prevalence of poverty among mother-only families. Although the rhetoric of the 1960s was to offer the poor “a hand up” and not a “handout,” the reduction in poverty in the late 1960s and early 1970s was due in large part to increased public spending on income transfers. After 1973, however, real cash welfare (AFDC) benefits began to erode, and the erosion accelerated after 1980. Monthly AFDC benefits averaged \$644 per family in 1970 (1992 dollars) but eroded steadily in the subsequent 25 years. By 1994 the value of real monthly family benefits was about \$350—about 55 percent of their value in 1970.

Children

The discouraging trends for mother-only families account for much of the growth in the number and percentage of the nation's children who live in poverty. At the beginning of the War on Poverty, the poverty rate of children younger than 18 was not much above that of the rest of the population (about 17 percent). Like the national poverty rate, the children's poverty rate fell until the early 1970s, when it reached a low of about 15 percent. Since then, the children's poverty rate has steadily increased. By 1980 children were about 40 percent more likely to be living in poverty than was the rest of the population; by 1997 the children's poverty rate stood at about 21 percent, more than 150 percent of the national rate. Indeed, nearly 40 percent of the nation's poor are children.



Low Education Youth, Especially Minorities

The third group comprising the “new poor” is youth, especially minority males aged 18–24. While it is not surprising that both earnings and employment levels for youth are below those of older workers, this pattern has become accentuated over the past two decades. Over the past 25 years, a large and growing group of youth have been unsuccessful in the labor market. From 1970 to 1997, the unemployment rate of 16–19-year-old black men increased from 32 percent to 37 percent, or by nearly 16 percent. Over the same period, the unemployment rate for young white men edged up from 14 to 15.5 percent. Similar racial disparities are observed for young men aged 20–24.

Numerous factors account for the deteriorating labor market performance of youth relative to adults. First, youth are far more sensitive than adults to swings in labor demand; just entering the workforce, they are a marginal group. For this reason, the fall in the relative economic position of youth has been accounted for in large part by the deterioration of the low end of the labor market since 1973.

Two demographic factors may also be relevant: new waves of immigration and the increasing labor force participation rates of women. There is some evidence that each of these influences has had an adverse effect on both the wages and the employment prospects of youth, especially on lower education and minority youth.

A third factor contributing to the decline in youth labor market prospects is the military. The nation’s military is dominated by young males, especially racial minorities. Since the Vietnam War, and especially since the fall of communism, the size of the military has been reduced significantly, releasing many young minority males to the private labor market.

Fourth, the relative shift of the job distribution toward “high-tech” jobs—skill-based technological change—has adversely affected the wage and earnings prospects of those youth with less than a college education. Finally, the relatively adverse family, social, and neighborhood environments of many minority youth should be recognized as one of the important reasons why their labor market experiences have lagged behind those of equivalent majority youth.

Solving Poverty and Inequality

During the 1960s, Americans seemed

convinced that government could combine scientific thinking and resources to solve pressing national problems. For a complex set of reasons, poverty became one of those problems, and the federal government set out to wage war on it. The problem was identified, the best minds gathered to address it, measurements of number and composition of the poor population were made, and a legislative agenda was prepared. Assessing and understanding the War on Poverty effort was to occupy economists and other social scientists for decades following the mid-1960s.

There was no single prevailing doctrine that drove the antipoverty effort, as economists, sociologists, and other social scientists all had their oar in the water. Although most observers saw economists as dominating the debate and formulating policy proposals, there was no unified economic point of view.

Perhaps the best characterization of economists’ thinking was offered by the late economist Robert Lampman of the University of Wisconsin–Madison. Lampman saw the poverty problem as multicausal, deriving from some combination of the following:

- events external to individuals (e.g., illness or disability, family dissolution, death of family breadwinner, unemployment),
- social barriers in the form of caste, class, and custom (e.g., racial and gender discrimination, employer hiring procedures, union rules), and
- limited ability . . . to earn (e.g., inadequate skills needed for the market).

Viewing the problem as multicausal led to a multipronged set of proposed policy interventions, and it is here that economists became separated.

The prevailing point of view among economists (and one that Lampman shared) was that external events were the major culprit, and among them unemployment was chief. For most economists, then, improved macroeconomic performance could abolish cyclical unemployment, and hence was the primary instrument for reducing poverty and securing widely distributed economic gains.

Some (primarily labor) economists argued that the economy confronted

serious structural imbalances, and hence that education and training measures should be the primary policy instrument. They were a distinct minority and tended to be derided by the majority.

The 1970s

Less than a decade after the War on Poverty began, the perspective of macroeconomists had shifted. By the mid-1970s, driving down the unemployment rate was seen to have potentially serious inflationary dangers. This revision in outlook was attributed in part to changes in labor force composition (e.g., the rapid increase of women, teenagers, and those without prior experience in the work force), which increased the natural rate of unemployment. The combination of high unemployment and high inflation that characterized the last half of the 1970s (the era of “stagflation”) further contributed to the change in outlook.

The economists’ view tended to undermine the case for education and training measures. The support for these policies was also undermined by the numerous evaluations of training interventions that found some success for a few groups, but little if any employment and earnings impacts for most groups.

During the decade of the 1970s, however, the economists’ perspective on the merits of a universal, comprehensive transfer system as a replacement for the categorical and piecemeal welfare system began to take hold. In 1969, the President’s Commission on Income Maintenance Programs (the Heineman Commission) had recommended “a universal income supplement program to be administered by the Federal government.” President Nixon had proposed his Family Assistance Plan, a low guarantee negative income tax, which failed in the Senate (having passed the House) because it was too conservative for liberals and too liberal for conservatives.

Senator Russell Long of Louisiana had another view of how to support low income people—public support should be given only if people worked and earned. He called his proposal an earnings subsidy, and in legislation it was referred to as the Earned Income Tax Credit (EITC). It was adopted in 1973.

The basic idea of a minimum income guarantee did not die, however, and was resurrected by President Carter in his 1977 Program for Better Jobs and Income.



It, too, failed to pass Congress after prolonged debate.

Although the economists' vision failed in the world of practice, policies toward poor families developed rapidly during in the 1970s. By the end of the decade, the Food Stamp program—a minor half-billion dollar effort to stabilize and support farm prices in 1970—had grown to a major program of assistance to all low-income families regardless of their work status or the cause of their meager income (see table 2). The coverage and benefits of Medicaid expanded, and real expenditures more than doubled from 1970 to 1980. Housing assistance for low-income families grew ten-fold during the decade, and tax expenditures on the EITC increased rapidly.

The 1980s

By the end of the 1970s, the nation was ripe for a new view of the nature of the problems of poverty and inequality and the operation of the labor market. It didn't have to wait long. In 1979 President Reagan was elected touting large work effort and savings gains from improved incentives and lower taxes, complaining about "welfare queens," and promising to end stagflation by getting the government off people's backs.

Critics of the social policies enacted in the 1960s and 1970s claimed that such policies undermined the functioning of the nation's basic institutions—family, church, community, and the workplace. The policies encouraged permissiveness and dependence, they said, leading to marital breakup, nonmarital childbearing, the substitution of institutional child care for that of mothers, youth joblessness, and

the erosion of individual initiative and respect for others.

The nature of the economic growth following the deep recession of 1982–83 raised still other questions regarding the effect of technological change and the structure and operation of the labor market. While the economy expanded, wage rates of low- and medium-skilled male workers did not, but the earnings of those in the upper tail of the distribution grew rapidly. The growing inequality of the 1980s prompted numerous references to the failure of rising tides to raise all boats during that decade.

Public support to the poor during the decade of the 1980s reflected these concerns; this was the era of retrenchment. In 1981 President Reagan proposed a program of mandated work for able-bodied welfare recipients combined with an increase in the benefit reduction rate to 100 percent (and the elimination of the income disregard) for those recipients who found paid employment. Congress approved the latter of these changes in the 1981 Omnibus Budget Reconciliation Act. This fundamental change in the structure of the AFDC program, together with legislative encouragement for states to establish narrowly focused work requirement programs (known as "welfare-to-work"), signaled a new culture of work expectations for single mothers with children.

The 1990s

New themes came to dominate policy discussions in the 1990s. One was macroeconomic, the other the dominance of value-driven policymaking. On the macroeconomic front, the policies of the

1960s, 1970s, and 1980s gave way to a new orthodoxy—namely, that long-run economic growth demands increased saving and investment. Fiscal restraint (with fixed deficit targets or balanced budgets) was seen as the recipe for attaining this goal. With the prolonged expansion subsequent to the recession of the early 1990s, deficits have fallen, and surpluses (perhaps as far as the eye can see) realized; all this along with falling unemployment, and high economic growth.

Simultaneous with this changed macroeconomic perspective came a new moral standard for judging individuals and their behavior, with implications for the role of the state in social policy. This standard emphasizes the merits of individual self-reliance. In this view, the real problem of poverty is the substitution of welfare for income generated by people's own efforts, fostering the creation of a dependent and dysfunctional social class.

The standard of "self-reliance" motivated the 1996 welfare reform legislation titled Temporary Assistance for Needy Families (TANF), the primary goal of which was to move recipients from reliance on cash transfers into work and earning. It also underlies proposals for the privatization of the Social Security retirement program, medical savings accounts as a replacement for Medicare benefits, shifts from defined benefit to defined contribution pension plans, and the emphasis on loans rather than grants to cover the rising costs of higher education.

Offsetting the erosion in welfare support, however, programs providing in-kind support to low-income families—primarily Food Stamps and Medicaid—expanded. The signal development in the nation's safety net was the substantial (phased-in) expansions of the EITC in 1990 and 1993. For a family with two children, the maximum credit went from \$953 in 1990 to \$1384 by 1992 to \$2528 in 1994. In 1998 it stood at \$3756. The increased generosity of the EITC removed some of the sting from the 1996 TANF legislation.

What Might the Future Hold?

As we stand at the beginning of a new millennium, most Americans find things to be "about as good as it gets." Employment is full, prices are stable, the stock market is high, wages are growing in line with productivity, important gender and racial

continued on page 24

TABLE 2

Public Sector Spending on Transfer Programs Targeted at Low Income Families, 1960-1996 (billions of 1996 dollars)

Year	AFDC/ TANF	Food Stamps	SSI	EITC	Medicaid
1960	5,407	n.a	12,207	n.a.	n.a.
1970	16,382	n.a	11,884	n.a	19,620
1973	25,030	8,036	12,079	n.a	32,196
1979	21,675	12,507	15,290	4,435	47,016
1983	20,102	18,547	14,814	2,828	55,066
1990	20,721	17,577	19,321	8,317	87,024
1996	20,411	23,510	28,252	25,935	161,963

Source: U.S House of Representatives, Committee on Ways and Means; U.S. Bureau of the Census



Mandatory Retirement in Higher Education: What Came True and What We Can Still Learn

By Karen C. Holden and W. Lee Hansen

This article is a shortened version of a chapter included in the forthcoming book from the University of Pennsylvania Press, To Retire or Not? Examining Retirement Policy and Behavior in Higher Education. The authors reflect on their earlier study, "Mandatory Retirement in Higher Education," submitted as a report to the U.S. Department of Labor in 1981. Karen Holden is professor of public affairs and consumer science at the La Follette Institute and in the School of Human Ecology. W. Lee Hansen is emeritus professor of economics.

When the federal government eliminated age-based mandatory retirement in 1994, it ended almost two decades of uncertainty regarding mandatory retirement age (MRA) policies in higher education. During those years academe faced periods of high inflation, which threatened to erode the real value of faculty salaries and pensions and thus, perhaps, delayed retirements and constrained operating budgets. This in turn limited the ability of institutions to expand and develop new programs by hiring new faculty. At the same time, the age distribution of faculty in higher education meant a rise in their mean age even without any change in retirement age policies. The prospect of uncapping the MRA was viewed with the same fears by academic institutions, as was the earlier rise (in 1982) in MRA from 65 to 70.

Predictions about the dire effects for colleges and universities of raising the minimum MRA from age 65 to 70 in the early 1980s and of subsequently uncapping the MRA in 1994 failed to materialize. Yet colleges and universities continue to express concern about faculty retirement issues: too many highly paid (but less productive) professors will continue teaching well into their 70s; costly early retirement programs must be developed to help prevent this from occurring; and the age-bunching of faculty hires from the 1960s will make the retirement problem even more acute in the coming decade.

This article describes and assesses the only nationally representative study of retirement policies and practices and of retirement behavior in higher education. We address three questions: (1) What are the institutional policies and individual characteristics that shape retirement timing? (2) What bearing do the findings from our earlier study on mandatory retirement have on understanding how institutions and individuals may respond to uncapping mandatory retirement? and

(3) What are our expectations about the likely pattern of faculty retirements over the coming decade and our recommendations for institutional policies?

The 1978 Amendments

The 1978 Amendments to the Age Discrimination in Employment Act (ADEA) raised the minimum allowed age of mandatory retirement from 65 to 70 for all Americans but granted a four-year exemption to institutions of higher education. Colleges and universities, thus, could continue to retire faculty forcibly as early as age 65 for reasons of age alone unless Congress made the exemption permanent, something it did not do. The subsequent 1986 ADEA Amendments eliminated mandatory retirement at any age, although once again higher education was exempt, this time through January 1, 1994.

The 1978 and 1986 exemptions for higher education were granted in response to strong opposition from academe to the loss of what was viewed as an essential human resource tool. The principal arguments rested on the academic enterprise's unique mission to educate the next generation of workers and scholars and to nurture intellectual and scientific advances. Thus, it was argued, orderly and predictable retirements were essential to creating opportunities to hire recently trained new faculty who would further this mission. In the absence of this means of compelling older faculty to retire, the intellectual atmosphere and rewards and the nonphysically demanding nature of the job would lead to unacceptable delays in retirement.

In addition, it was generally accepted wisdom that the defined-contribution plans—plans based on employee contributions and interest earned on them—covering faculty in private institutions, in contrast to the defined-benefit plans—plans based on a formula that usually includes final average salary and years of

service—in public institutions and private industry, provided a financial incentive to delay retirement well past the plan's "normal" retirement age.

Because so little was known about the actual effect of MRA policies on retirement behavior even for the general workforce, a provision of the 1978 legislation called for the U.S. Department of Labor to carry out studies of the effect of raising the MRA to 70, including a separate study specifically on its impact for higher education. In 1979 we were commissioned to undertake the study of ending the 1978 exemption for tenured faculty.

Our study addressed four major questions: (1) What MRA policies prevailed in higher education? (2) What effect did these and other personnel policies have on the age of retirement of faculty members? (3) What would be the likely, first-round effects of raising the MRA from 65 to 70? (4) What adaptations in behavior both by higher education institutions and faculty would be triggered by such a change?

Although the surveys were conducted in 1979-80 and the study was completed in 1981, the findings on the determinants of retirement timing remain relevant to the current debate over the consequences of finally eliminating mandatory retirement in higher education. This claim stems from the following observations: (1) the underlying factors shaping retirement behavior have not changed to any substantial degree; (2) TIAA-CREF (the largest teachers retirement system) and state plans continue to be the principal retirement plans for the vast majority of faculty members and thus shape retirement options despite somewhat greater flexibility since then in benefit structure and supplemental annuity options; (3) evidence on retirement rates from those few institutions that in 1979-80 had no mandatory retirement age both anticipated and are suggestive of the effects of



raising the MRA to 70 and eventually uncapping it in 1994.

Lessons Learned

The most relevant lessons from our study include the following: (1) the absence of a comprehensive database limits the ability of higher education administrators to understand determinants of retirement among faculty members and to respond to externally mandated personnel policy changes; (2) liberal policies on employment extensions in those institutions with a younger MRA result in similar retirement age patterns on average between institutions with older and younger MRAs; (3) type of plan (i.e., defined benefit or defined contribution) does not matter in explaining differences in retirement age across institutions and individuals; (4) expected age of retirement is affected by whether the institution is public or private, and whether the institution is devoted primarily to research or to teaching; (5) while the average expected age of retirement is different for faculty members in public and private institutions, this difference cannot be attributed to MRA policies; and (6) although eliminating the MRA would lead to some faculty continuing longer than they otherwise would be able to, it is the more productive faculty members who tend to retire later.

Distribution and Enforcement of MRA Policies

Our study found that MRA policies were neither universal nor strictly enforced during the period when they existed. This meant their potential impact on retirement timing varied across institutions and that the impact of eliminating the MRA was moderated. Just prior to passage of the 1978 ADEA Amendments, 84 percent of all responding institutions had some age of mandatory retirement with the majority (73 percent) setting this age at 65, 20 percent at 70, and the remainder having no MRA. A sharp contrast was evident between public and private institutions, with fewer than half the public universities (46 percent) and public four-year colleges (47 percent) having a mandatory retirement age of 65 as compared to 81 percent and 67 percent of private colleges and universities, respectively.

By the time of our survey—in 1980, about two years before the expiration of the exemption—only one-third of all full-time faculty members were employed in institutions with an MRA of 65 (see table 1); another half were covered by an MRA of 70, while the remaining 12 percent were subject to no MRA. Public institutions had moved most rapidly after 1978 to raise their MRA; 56 percent of public institutions

with an MRA below 70 had raised or eliminated their MRA in contrast to only 25 percent of private institutions. As a result, among institutions with an MRA in 1980, only 26 percent of public universities and 34 percent of public four-year colleges had an MRA of 65 in 1980 as compared to 64 percent and 61 percent, respectively, for comparable private institutions.

Mandatory retirement does not require total separation from academic employment, and institutions reported considerable flexibility in its application. Only a small fraction—13 percent—of all institutions in our survey that reported an MRA of 65 responded that retirement was in fact required at that age. Extensions beyond that date were standard, with most institutions reporting no age limit for extensions while others granted extensions for one to five years.

In effect, the MRA in higher education signaled the end of a tenure contract at which time some faculty members could continue their teaching and research, perhaps after a review by colleagues or administrators on their ability to continue to perform effectively. The ability to extend service beyond the formal MRA meant the exemption's expiration promised to have a smaller impact on retirement timing than might have been expected although its expiration would clearly alter the nature of the post-65 employment contract.

Expected and Actual Retirement Ages

Few faculty members plan a complete cessation of academic work after retirement." In this study, we defined retirement as that age at which a person ceased employment at the institution at which he or she held a full-time, tenured job at the time of our survey. It is this institutional-based job change that is the issue in estimating MRA effects on institutional retirement patterns and budgets. Thus, our data on retirement patterns refer to the age at which faculty separate from the institution at which they are employed, regardless of whether they seek a post-retirement teaching assignment elsewhere.

The reported prevalence of service extensions beyond the official MRA in part explains why the average actual retirement age for faculty—even at schools with a 65 MRA—was higher than that. The average expected retirement age among faculty who would reach age an MRA of 65 before the exemption expired

TABLE 1

Distribution of Full-time Faculty by Mandatory Retirement Age and By Type of Institution: 1980

Type of Institution	Percent of All Faculty		Percent of Full-time Faculty with MRA of Age		
	With No MRA	With MRA-Total	65	66-68	70+
PRIVATE	1.2	21.9	13.0	1.4	7.5
2-year	0.3	0.5	0.2	0.0	0.3
4-year	0.9	14.5	8.3	0.6	5.6
university	0.0	7.0	4.5	0.8	1.7
PUBLIC	11.1	65.7	19.4	2.6	43.7
2-year	6.2	19.7	10.9	0.0	8.8
4-year	3.7	25.8	5.2	0.0	20.6
university	1.2	20.2	3.3	2.6	14.3
TOTAL	12.4	87.6	32.3	4.0	51.3

Source: Table VI-8, Holden and Hansen, "Mandatory Retirement in Higher Education." Madison, Wis.: Department of Economics, University of Wisconsin-Madison. Report submitted to the U.S. Department of Labor, Contract #J-9-E-9-0067, October 1981.



was also above 65. We examined differences in expected retirement age by age of MRA prevailing at the institution.

Although faculty members employed in institutions with an MRA of 65 had a somewhat lower expected retirement age (66.3 years vs. 67.2), the striking difference is between retirement ages in private and public institutions. Indeed, the average expected retirement age at public institutions with an MRA of 70 is identical to that at private institutions with an MRA of 65. Expected retirement from public institutions was significantly earlier than from private institutions, regardless of the MRA in effect (i.e., whether it is age 65 or 70).

Type and Value of Retirement Plans

Because virtually all institutions offer their faculty members some kind of pension plan, the question for colleges and universities is not whether having a pension makes a difference to retirement timing, but rather the influence of different plans on retirement timing of individual faculty members. Faculty in our survey who were employed in private institutions were covered primarily by TIAA-CREF while those at public institutions were covered by a state retirement plan. Thus, to some extent perceptions of and empirical estimates of MRA effects are confounded by systematic differences between public and private institutions in both MRA and plan type. Yet the gains to postponing retirement under a defined-contribution or defined-benefit plan vary considerably across individuals covered by each type. They can on average be identical in the two types of plans since the relative gains will depend on how formula-based pensions increase due to increases in earnings and service compared to prevailing investment earnings. We estimated these gains for faculty in our sample using 1981 prevailing interest and earnings gain expectations.

For each institution we estimated the pension for which a faculty member would be both eligible at age 65 and at 66, assuming service and salary profiles were identical. The benefit at age 65 and the gain in pension upon delaying retirement by one year was almost identical on average for faculty in TIAA and in public plans. This indicated that, contrary to the then prevailing wisdom, on average the benefit gained by including one more year and a higher salary was equivalent to the

then-actuarial gain and additional dividends provided by TIAA. One explanation is the short salary-averaging period (typically three years) in defined-benefit plans in higher education, which in combination with additional years of service lead to relatively high gains from continued work if salary increases are generous.

Although other relative salary gain and investment earning scenarios would alter these comparative estimates, our pension simulations showed that relative market and compensation conditions, not basic plan types, determine the gains to postponed retirements. These similar averages between the two types of plans, however, obscure enormous variations within each type of plan. For example, the most generous public pension offered a benefit 2.5 times that offered by the least generous state plan to an identically positioned faculty member.

Separate Effects of an MRA and Other Factors

We assessed the separate effect on average retirement age of an MRA by estimating a retirement model built around the assumption that faculty members are influenced by the relative rewards of retirement versus those of continuing employment in their current positions.

Three main conclusions emerged: First, an MRA of 65 appears to have a relatively small effect on retirements, raising the probability among faculty 60-69 of retiring before age 65 by about 12 percentage points and before 70 by about 22 percentage points. Second, private institutions, even after adjusting for average annuity wealth offers, could still expect to experience lower rates of retirement—by about 12 percentage points before age 65 and by about 15 percent before age 70. Third, the continuation of other fringe benefits into retirement have an equal or larger impact on retirement timing. Health insurance continuation offers raise the probability of retirement before age 65 by about 14 percentage points.

Pension wealth, however, had no effect on the actual retirement probabilities, a result perhaps of having to use a value for hypothetical faculty members whose characteristics are identical across institutions, whereas actual retirement rate differentials across individuals will be influenced by differences in individuals' earnings profiles and job histories. This is consistent with

our earlier conclusion that it is not broad pension type that matters, but how pension policy interacts with institutional-specific hiring and salary policies.

The matched institutional-faculty data enabled us to estimate a second retirement model, this time of retirement age expectations of individual faculty members. It also enabled us to incorporate the richer matched institutional-individual data including that on other financial assets held by the individual. The pension wealth variable was based on individual salary-service and contribution profiles. The major conclusions we draw from this analysis follow.

Among the older group, the presence of an MRA of 65 accelerated retirement by about 1.1 years. This contrasts with the separate effect of employment in a private institution that alone raised the retirement age by even more—1.5 years later than faculty at public universities. An MRA of 65 had no effect on the retirement plans of younger faculty since they knew then they would be able to work up to age 70. For the younger faculty, however, the further they were from age 65, the younger they expected to retire.

We were surprised to find that the level of pension wealth did not affect retirement timing for the older faculty, although for younger faculty the additional gains anticipated in earnings and pensions had a delaying effect on the expected age of retirement. Perhaps the most relevant finding for predicting uncapping effects was the increased chances of delaying retirement as non-salary professional income rose.

Our major conclusion was that it was the combination of rewards provided by higher education to continued employment that mattered with an MRA, especially when applied flexibly, playing a relatively small role. Factors that remain under control of administrators—salary increases, pension benefit gains with continued work, and research support—encourage faculty to plan a relatively late retirement. Indeed, our interpretation of the effect of non-salary professional income on retirement timing is that faculty engaged in consulting activities depend on an institutional affiliation for the continuation of those activities. While in some occupations opportunities to earn outside a regular job may continue even after (early) retirement, this appears not



to be the case in academe where the receipt of outside income may be conditioned on an institutional affiliation and use of institutional facilities. Our conclusion on the importance of on-going institutional affiliation to the ability of faculty members to continue receiving outside income suggests the potential effectiveness in lowering the retirement age of office and research support offers to emeritus faculty.

Finally, our analysis of both actual and expected retirement timing highlights once again the difference between public and private institutions: at the latter, faculty expect to retire later even after controlling for pension and MRA policies. We conclude that the perception that pension plan type matters (with defined-contribution plans such as TIAA-CREF encouraging later retirement) is wrong. The public-private variable is picking up some other aspect of retirement policies of the academic environment that encourages earlier retirement.

Effects on Budget and New Hires

We used our data on faculty age structure and retirement expectations to simulate the effect on budget and new hiring of having an age 65 versus age 70 MRA. Assuming constant faculty size, the higher MRA would raise average budget costs within the first five years by about 2 percent. New hires initially drop by about 20 percent below the level prevailing with an MRA of 65 but then begin to slowly rise, back to near but not quite up to their old levels. When the simulations are undertaken with different faculty age structures the effects in five years on faculty budget costs ranges between 1.7 and 3.7 percent with a fall in that percentage and a narrowing of the range over time. For new hires as well the largest impact on the number of hires is in the short term but quickly diminishes. For the oldest age distributions hirings are actually greater in some later years than they would have been under a younger MRA.

Early Retirement Incentives

Because other personnel tools will have to be used in an era of a higher (and uncapped) MRA in order to manage retirements, we explored the attractiveness of several early retirement incentives (ERI) on expected retirement timing. Faculty respondents were presented with three hypothetical offers: (1) their pension benefit levels would not be reduced if they

took early retirement; (2) their pension benefits, though reduced for early retirement, would be fully adjusted for cost of living changes during their entire retired life; and (3) faculty could phase down their workload, with proportionate reductions in their salaries in the years immediately prior to their currently expected retirement age. We asked individuals not only about their interest in each plan but also the age at which they would definitely or possibly take up one of these options.

Among faculty members in our survey (all of whom were age 50 or older) about 25 percent said they would definitely retire earlier if there were no penalty for early retirement. While another 27 percent said they possibly would retire earlier, 41 percent said they definitely would not be interested. The average age at which people said they would retire under such an offer was age 62 compared with their average expected retirement age of 66. Despite then high prevailing rates of inflation, only 22 percent of faculty said that with a fully inflation-indexed pension they would definitely retire earlier and would do so at age 62. The option attractive to the most faculty was the phased-retirement offer; 37 percent said they would definitely take such an option although 47 percent expressed absolutely no interest.

Faculty age affected the attractiveness of these options, a conclusion that has important implications for the short- and long-term impact of early retirement offers. Faculty members age 65-69 expressed no interest in retiring earlier. These options were also of little interest to the 50-59-year-olds whose expected retirement ages were already relatively early. These options mattered most to the age group 60-64, who on average expected to work another six years. Because an ERI offer appeared to accelerate retirement—and by even more than did an MRA of 65—we conclude that these may be powerful tools for managing retirement timing. Faculty actively engaged in research, as well as those who were not, were equally likely to accelerate retirement, although the former group made this change from an already later age of retirement. Thus, it appears that with appropriate early retirement incentives, both more productive faculty members and less productive faculty members, who already plan to retire somewhat earlier, can be

encouraged to retire earlier than they had expected to retire.

At the time of our survey, few institutions offered ERIs that were anywhere near as attractive as these options. In the institutional survey, we tried to obtain data on early retirement benefits. About 20 percent of all institutions reported some form of early retirement incentives in their pension plan, including 36 percent of private universities and 22 percent of public universities. Closer examination of institutional early retirement incentives revealed that almost half were optional tax deferred annuity plans available to faculty members through salary reductions under IRS code, section 403(b). While the responses indicate a realization by administrators that financial incentives are important to retirement timing, these tax deferred annuities offered no greater advantage to earlier retirement than would any defined-contribution pension plan.

Institutions were also asked about the ability of faculty members to reduce workloads prior to normal retirement age. Overall, about one-third allowed this option, with public universities, in particular, most likely to allow faculty to work part time. Unfortunately, because nothing is known about the conditions faculty must meet to take advantage of this option, it is impossible to evaluate the attractiveness of decreased workloads. Only 31 percent of institutions with a 65 MRA offered a part-time teaching option compared with half of those with a 70 MRA. This suggests that institutions with higher mandatory retirement ages and public institutions have adjusted in part by offering the option of reduced work loads.

How Serious Is the Impact of Uncapping?

If an MRA has an effect on any individual's retirement plans, a change in that policy would lead to some increase in the number retiring after age 70. This increase would be smaller for those institutions that had liberally provided for extensions beyond their formerly established MRA. Thus, it is not surprising to see some small number of faculty delaying retirement beyond age 65 with the rise in the MRA and beyond age 70 after uncapping. An opposing effect of uncapping the mandatory retirement age might also be

continued on page 23



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continued from page 4

financial means to pursue them. Administrative and judicial budgets and staffs are finite.

Nonetheless, judicial and administrative remedies can complement market and legislative measures. The mere threat of judicial or administrative intervention can significantly contribute to changed business practice. Even where this threat is limited in practice, human resource departments and attorneys make businesses aware of its potential.

The Transatlantic Context

The EU directive is affecting the regulation of privacy in the United States by all U.S. institutions. This section first examines the role of EU market power in U.S.–EU negotiations over data privacy standards. It then assesses the multiple public and private means through which Europe can restrict data transfers to the United States, and the attempts by U.S.–EU authorities to manage the resulting regulatory conflict.

Bolstering Market Power

The U.S.–EU dispute over the adequacy of U.S. data privacy protection affects U.S. privacy policies and practices because the EU exercises market power. Simply put, the EU market matters to U.S. business because the EU is by far the United States' largest trading partner and the site of most U.S. foreign investment. In 1997, the United States exported \$253.6 billion of goods and services to the EU and imported \$270.3 billion of goods and services from the EU. A potential restriction on transatlantic data flows matters.

The United States increasingly negotiates with the EU as an independent political institution apart from the EU's fifteen member states. As U.S. Assistant Secretary of Commerce Franklin Vargo states, the New Transatlantic Agenda signed by the United States and EU in December 1995 "marks the first time that we are dealing with the EU as a political institution on a large scale." A central purpose of the New Transatlantic Agenda is to coordinate and spur further trade and investment liberalization, both transatlantic and global. By delegating trade negotiating authority to EU institutions, the EU member states have been able to speak with a single, more powerful voice, facilitating the negotiation of tariff reductions and other

trade liberalization measures and enhancing the EU's role in these negotiations.

Restricting Data Transfers

EU data privacy regulation poses multiple threats to U.S. companies. The EU, in response to a proposal of the European Commission approved by a qualified majority vote of member states, may ban all data transfers to countries that fail to ensure adequate data privacy protection. Even if, as appears likely for political reasons, the Commission refrains from finding that the United States, as a whole, inadequately ensures data privacy protection, it can limit its determination to certain economic sectors, types of information, or operations.

EU regulatory policy significantly affects the playing field in the United States.

Member state authorities can also independently fine individual companies and enjoin them from transferring data, including to their U.S. affiliates. Company officials can even be imprisoned. Though imprisonment is unlikely, company officials will not wish to test its likelihood. Privacy rights associations can trigger these proceedings by filing claims with supervisory authorities. They have put companies on notice that they will do so.

Individuals and, depending on member state standing rules, privacy rights associations can also sue companies for damages before member state courts or through referral to administrative bodies. In the Internet era, U.S. companies whose only presence in Europe is the availability of their web sites, can be subject to claims before European courts. American companies are already subject to EU-based claims. The United Kingdom fined U.S. Robotics, for example, "for failing to register under the UK's Data Protection Act and for obtaining personal information about individual visitors to its Web site and then using that information to market other products." American Airlines is appealing a Swedish court ruling that bars it from transferring data from Sweden to its U.S.

electronic reservation system without first obtaining customer consent. Other data transfers to the United States have been barred by British, French, and German courts and administrative authorities.

U.S.–EU Negotiations Over Adequacy

The United States and the EU are attempting to negotiate a solution to the data privacy controversy. Pressure from U.S. firms makes this a high profile issue for the U.S. administration. In line with business views, the Clinton administration maintains, as its negotiating position, that industry should be "self-regulating" in its use of personal data (advocating the market as primary institution). U.S. Commerce officials defend U.S. practices, critiquing the EU for its "top-down approach" of "privacy czars and bureaucrats," which are antithetical to U.S. traditions of limited governmental intrusion in the private sector. Yet to avoid a regulatory conflict, U.S. officials simultaneously prompt businesses to create "self-regulatory" procedures more protective of individual privacy. Entering the fray, U.S. privacy advocates, skeptical of "self-regulation," press for further legislation.

The EU has delayed enforcing the directive's provisions on third country transfers while negotiations take place. The United States remains a formidable negotiating opponent because the U.S. market is also the largest foreign market for EU firms, buttressing U.S. negotiating clout. EU commercial interests press their member state representatives and EU officials to avoid a transatlantic trade war over data privacy issues. A ban would impede not only data transfers, it would hamper further tariff negotiations and mutual recognition agreements in areas important to both large U.S. and EU commercial interests.

The United States proposes that the EU agree to a set of core data privacy protection principles pursuant to which U.S. company "self-regulation" would be deemed adequate so long as it complies with these principles. The U.S. maintains that compliance must provide companies with a "safe harbor" against any challenge by EU authorities of their data processing practices. The EU, however, rejected initial U.S. proposals as inadequate. Although U.S.–EU negotiations continue, the EU confirms that it will enforce the directive's provisions banning data transfers to third countries if a solution is not reached.



International Trade Rules

World trade rules constrain the extra-jurisdictional effects of EU regulatory dictates and can preserve U.S. national autonomy. Not surprisingly, in an attempt to ward off EU action, U.S. officials have implicitly threatened to challenge any ban imposed by the EU before the Dispute Settlement Body of the World Trade Organization (WTO).

WTO members' obligations in service sectors are relatively limited under the General Agreement on Trade in Service (GATS). When a data transfer is covered by a specific sectoral commitment agreed to by the EU under GATS, the EU is obliged to treat U.S. services and service providers as favorably as EU services and service providers, and to apply its domestic regulation in a "reasonable" manner. In addition, if the EU were to ban data transfers only to the United States, but not to other WTO members with inadequate data privacy protection, it would be violating the GATS most-favored nations clause.

The United States would likely not prevail in an action before the WTO Dispute Settlement Body—for three primary reasons. First, on its face, the directive applies equally to EU-registered companies and foreign-registered companies and thus should not violate the GATS national treatment or most-favored nation clauses. So long as the EU does not clearly discriminate against the United States or U.S. service providers in its application of the directive, the United States would likely not prevail.

Second, the EU has a legitimate public policy objective—to protect the privacy of EU residents who are the subjects of data transferred to the United States. Given that the privacy interests of EU residents are directly at stake, it is unlikely that a WTO panel would find non-discriminatory restrictions applied under the directive to be "unreasonable."

Third, the WTO Appellate Body, under close media scrutiny, would prefer to refrain from engaging in a close balancing of trade and privacy interests, and rather review the process by which the EU takes account of foreign privacy protections. This is the approach recently taken by the WTO Appellate Body in the U.S. shrimp-turtle case, in which it enumerated a number of criteria that should support an EU defense. For example, the EU has studiously assessed U.S. practices affecting the

privacy of EU residents; U.S. authorities and companies have had access to EU officials to comment on the directive and its applications; and the EU has engaged in prolonged, detailed discussions with U.S. representatives to examine "adequate" (as opposed to identical) data privacy safeguards which could be applied.

WTO rules are often criticized for limiting the ability of countries to enact socially oriented legislation. They are primarily "negative" rules, obligating states, among other matters, not to restrict imports on account of non-product-related foreign production methods, such as "unfair" environmental or labor practices that result in foreign environmental harm or foreign labor repression. Paradoxically, in the case of data privacy, rather than protecting the United States from coercion to raise U.S. privacy standards, WTO rules shield the EU from a countervailing retaliatory threat. Were the United States to retaliate against the EU for harming U.S. commercial interests, it would violate WTO rules and be subject to an EU complaint. WTO rules thereby reinforce pressure on the United States to negotiate with the EU a set of "positive," more stringent, data privacy requirements—a trading up of U.S. standards.

The Directive's Impact: Changing the Stakes of U.S. Domestic Players

U.S. businesses feel the greatest impact of the directive because they engage in more European transactions than other foreigners and they make the most sophisticated use of information on account of their technological edge. U.S. businesses are now on the defensive about their practices. So are officials in the U.S. Department of Commerce who represent U.S. business interests abroad. The context in which U.S. domestic debates over data privacy protection take place has been altered.

Enhanced U.S. Regulatory Effort

The U.S. administration is divided over data privacy issues. The U.S. Commerce Department has advocated a more market-based approach, focusing on the role of business "self-regulation." It has taken a hard line against the directive as an over-reliance on "big government" and in itself an "invasion of [business] privacy." Other members of the Clinton administration and the Federal Trade Commission (FTC) have taken—relatively speaking—a more legislative approach, urging

Congress to enact certain enhanced data privacy protections. Vice President Gore has asked Congress to pass an "electronic bill of rights" guaranteeing on-line privacy, in particular as regards medical and financial records. In the fall of 1998 the FTC successfully lobbied for greater online data privacy protection for children. Although the United States may formally present a united front in negotiations with the EU, many people in positions of power in the U.S. administration share the EU's goals. While U.S. authorities defend U.S. commercial interests vis-à-vis the EU, they simultaneously use the directive's pressure as a tool to press Congress and businesses to ensure these very privacy protections.

The directive, together with the potential for further U.S. legislation, also enhances the FTC's leverage in working with businesses to change their market practices. The FTC conducts periodic public workshops on data privacy issues that bring together federal regulators, technology experts, businesses, and privacy advocates. The workshops have addressed the directive's requirements, which provide a yardstick against which business practices may be measured.

To avoid a regulatory conflict with the EU, the United States has proposed that the EU agree to a set of core data privacy protection principles pursuant to which U.S. company "self-regulation" would be deemed adequate so long as it complies with these principles. The Department of Commerce issued draft Safe Harbor Principles in November 1998, within a month of the directive becoming effective. The guidelines set forth seven data privacy principles for industry to follow which, if accepted by the EU, would be deemed "adequate" under the directive's criteria and thereby provide business with a "safe harbor." The proposed principles were revised by Commerce following intensive U.S.-EU negotiations. The version as of October 1, 1999, provides as follows:

- **Notice.** An organization must provide "clear and conspicuous" notice to individuals "about the purposes for which it collects information about them, how to contact the organization with . . . complaints, the types of third parties to which it discloses the information, and the



... means ... for limiting its use and disclosure.”

- **Choice.** An organization must provide individuals with a “clear and conspicuous” choice to “opt out” of how their personal information may be used and to whom it may be disclosed. An “opt in” choice must be provided for “sensitive information,” including “medical and health information.”
- **Onward Transfer.** When transferring personal information to a third party, an organization must require the third party to provide at least the same level of privacy protection as required by the relevant safe harbor principles, including consistency “with the principles of notice and choice.”
- **Security.** Organizations must take reasonable measures to assure the reliability of information and protect it from disclosure or loss.
- **Data Integrity.** Organizations “may only process personal information relevant to the purpose for which it has been gathered,” and “take reasonable steps to ensure that data is accurate, complete and current.”
- **Access.** An organization must grant individuals “[reasonable] access to personal information” held about them and the opportunity to have it corrected.
- **Enforcement.** There must be “mechanisms for assuring compliance” and “consequences” for noncompliance, which must include “readily available and affordable independent recourse mechanisms” and “sanctions [that] must be sufficiently rigorous to ensure compliance.”

If a company adopts the Safe Harbor Principles and fails to comply with them, it subjects itself to challenge by the FTC for “using unfair or deceptive acts or practices in or affecting commerce.” The FTC has, in fact, already brought two enforcement actions. One was in the fall of 1998 and the other in early 1999. Were there no directive or Safe Harbor Principles, companies would be less inclined to notify consumers of company privacy policies.

Were companies not induced to adopt privacy policies, the FTC would have no jurisdiction to intervene. In this backhanded way, the directive effectively fashions enhanced U.S. data privacy requirements, potentially becoming the baseline standard within the United States.

The EU has helped determine the content of this quasi-legislation. Ultimately, the effectiveness of Commerce’s “safe harbor” against data transfer restrictions depends on whether EU authorities recognize the principles as legally binding. While the ultimate outcome of U.S.–EU negotiations may not satisfy U.S. data privacy advocates, at a minimum the directive has provided leverage to press large U.S. businesses to adopt fair information practices that they otherwise would ignore.

The U.S.–EU conflict over data privacy protection demonstrates that in a globalizing economy, social protection levels are not necessarily driven downward.

Opportunities for Public Advocacy Groups and Privacy Service Providers

Data privacy advocates have attempted to use the directive to challenge lax business practices in the United States. Beginning in the fall of 1998 when the directive first went into effect, it was featured, together with EU negotiations over the “adequacy” of U.S. protections, in the *New York Times*, *USA Today*, *Washington Post*, *Wall Street Journal*, and *Financial Times*, among other periodicals read by business representatives and policymakers. Numerous symposia were held which addressed the “adequacy” of U.S. data protection practices in light of the directive. The directive and the publicity it received drew attention to data privacy advocates and provided leverage for their efforts. It also provided advertising for service providers who profit from assisting firms comply with legal requirements.

The Role of Privacy Advocates

Privacy advocates play an important role because they are “repeat players” in ongoing negotiations over U.S. data privacy rules. They are, in this way, different from individuals who transact with companies on an ad hoc basis and commence “one-shot” disputes when their privacy interests are impinged. As repeat players, privacy advocates have larger time horizons in which to implement strategies. They have a greater incentive to expend resources to influence the making of relevant data privacy rules, whether through threatened product boycotts, legislative lobbying or judicial challenge.

Even though privacy advocates critique the Commerce Department’s Safe Harbor Principles, privacy advocates will use them, if adopted, as part of their larger strategies. It is privacy advocates who will test new “access” rights. It is privacy advocates who will work as private attorneys general, with the FTC, other U.S. agencies, and EU and member state authorities to force companies to adhere to the policies they announce. The directive induces the creation of new legal tools within the United States that U.S. privacy advocates can exploit.

The Role of Privacy Service Providers

The directive not only incites privacy advocates to challenge lax business practices more effectively, it also increases the demand for their services and the services of for-profit enterprises. The Center for Social and Legal Research, a “privacy think tank” based in Hackensack, New Jersey, works with multinational companies in drafting codes of conduct incorporating the directive’s requirements. The Center’s director, Alan Westin, provides consulting services to the Better Business Bureau OnLine on its new privacy seal program. The Electronic Frontier Foundation, a San Francisco-based public interest organization, has associated with information technology companies to launch a program named TRUSTe to rate the privacy protection of Internet sites. The directive has provided an opening for privacy advocates not only to goad and shame businesses, but also to collaborate with them in raising internal company standards.

The directive has fostered the formation of a new service industry for the certification and monitoring of self-regulatory programs. The U.S. Council of Better



Business Bureaus markets itself as a provider of independent, timely, reliable certification services. TRUSTe similarly works with major accounting firms to review information processing practices of firms displaying the TRUSTe seal. To drum up business, TRUSTe consistently refers to the directive, noting how TRUSTe looks “for ways to incorporate ‘adequacy’ as defined in the directive into our program” and “bridge the Internet privacy gap for companies who do business in Europe or are thinking of forging an international presence.” The American Institute of Certified Public Accountants (AICPA) has created an analogous program entitled CPA WebTrust, under which they propose to evaluate web sites, conduct audits of firms’ privacy practices, and recertify participating firms every three months. In determining its criteria, the AICPA takes account of “safe harbor” guidelines. Legislation, in this case foreign legislation, can raise the standards to be certified.

The directive has spurred the creation of a new corporate position—the director of privacy issues in companies’ human resources divisions. These company employees attend conferences on the directive and U.S. privacy legislation, write memoranda on privacy issues that they distribute within firms, and generally increase firm awareness of privacy issues. In formulating and overseeing the implementation of company policies, they foster company compliance with applicable legal requirements.

Even if the risk of EU restrictions is minute, lawyers benefit if their clients take the law seriously. In-house counsel has an interest in being heard within the firm’s hierarchy. Outside law firms distribute manuals and memoranda on the directive to clients and prospective clients. Their memoranda highlight why U.S. businesses must pay close attention to the directive’s requirements. At symposia, they market contractual precautions that can be drafted and implemented to reduce the risk of European intervention.

The directive also stimulates the development of new technology that protects privacy interests. NCR, the information technology company, offers new database software that facilitates “a consumer’s right of access to information,” responding to a major sticking point in U.S.–EU negotiations. Under NCR’s new data

privacy initiative, NCR markets consulting services to assist companies comply with U.S. and EU governmental requirements and self-regulatory objectives. The directive’s threat to business concerns stimulates new business ventures. These ventures capitalize on privacy advocates’ exhortations, FTC workshops on fair information practices, and the prospects of future U.S. legislation and EU intervention.

U.S. Business Reactions

U.S. businesses have vehemently objected to the EU’s demands. They work independently and join business associations to lobby governmental representatives to defend their interests against EU intervention and leave data privacy to business self-regulation. They spend large sums on lobbying because they calculate that new data privacy legislation would raise business costs and constrain business opportunities.

In promoting “self-regulation” as an alternative to EU regulation, however, businesses are simultaneously pressed to raise their internal standards. Suddenly, businesses and business associations are developing a plethora of data privacy protection “principles,” “guidelines,” model contracts, and other schemes. The Paris-based International Chamber of Commerce has developed model contract provisions. The Direct Marketing Association has created “Guidelines for Personal Information Protection.” In June 1998, a group of fifty-one large businesses and business associations formed the Online Privacy Alliance, which immediately devised a set of privacy guidelines. The timing of these multiple efforts in conjunction with the directive’s coming into force in October 1998 is no coincidence.

Business groups are caught in a bind by Commerce’s Safe Harbor Principles. On the one hand, they strongly support Commerce’s efforts to negotiate a “safe harbor” with EU authorities that protects business from EU data transfer restrictions. On the other hand, they fear that the Safe Harbor Principles will lead to more costly data privacy requirements in the United States.

While the Safe Harbor Principles do not formally apply to purely domestic data processing operations, enterprises recognize that it will be difficult for them to use two sets of data privacy practices, one for EU residents (providing for greater

privacy protection), and one for U.S. residents (providing for less). Business databases will often include information about EU and U.S. residents, in which case businesses will have to comply with the EU’s more exacting requirements. In addition, if businesses provide greater data privacy protection for EU residents than for U.S. residents, they prejudice their public image. Privacy advocates have already jumped on this, proclaiming that U.S. citizens should not be treated as second-class citizens in their own country.

The spillover effects of EU requirements on U.S. business practice are already occurring. Oracle responded to the EU requirements “by tightening access to its customer and employee databases.” In conjunction with its joint venture with Bertelsmann, the German media conglomerate, America Online announced, “We will do whatever needs to be done in full compliance with the [EU] law.” When Citibank encountered problems with German data protection laws (which are similar to the directive), in order to continue transmitting data transatlantically, it entered into an “Inter-territorial Agreement” to assure adequate data privacy protection, which was subject to German law and could be enforced by German authorities. U.S. corporate groups are being pressured to import the practices that Europe requires into the United States.

Conclusion: Trading Up Standards

Through its political and economic clout and the demands of its marketplace, the United States influences foreign regulatory policy and business practice. It is often criticized for exporting its norms and imposing its standards on foreign countries. But the impact of the EU directive demonstrates that the actions of other powerful states also shape U.S. regulation and business practice. Although the scope and content of the U.S. regulation of data privacy protection depend substantially on domestic factors, EU regulatory policy significantly affects the playing field in the United States on which competing interest groups clash. EU external pressures enhance the impact of U.S. internal pressures. It prods U.S. businesses to change their behavior to avoid confrontations with EU regulators. It prompts U.S. regulators to press U.S. businesses to tighten their internal standards to avoid a regulatory conflict. It presents U.S.



privacy advocates with a functioning alternative to U.S. law which they can promote. By changing the stakes of U.S. actors, the directive torques the way all U.S. institutions—legislatures, regulators, courts, and markets—address data privacy issues. As Marc Rotenberg of the Electronic Privacy Information Center affirms, “All the energy spent on the EU directive has caused the United States to focus on privacy and raising our privacy standards.”

Where firms operate in multiple jurisdictions with differing regulatory requirements, they often demand that requirements be harmonized. Critics of globalization maintain that this harmonization process can lead to low regulatory standards—the lowest common denominator. Yet the U.S.–EU conflict over data privacy protection demonstrates that in a globalizing economy, social protection levels are not necessarily driven downward. Regardless of the outcome of discussions between the United States and the European Union, U.S. companies with operations in Europe—even where those operations simply involve the gathering of information from a web site—are pressed to conform their data processing practices toward EU standards.

Five primary factors explain why globalization pressures potentially drive U.S. social protection upward in the area of data privacy.

The Link with Liberalization. Economic liberalization and data privacy protection are intrinsically linked. Firms wishing to participate in a globalizing economy face conflicting regulations. The regulation of data privacy, in particular, matters to firms because it affects the exploitation of information, which is increasingly important in a technology-driven, network-linked, globalizing economy. Firms demand that conflicts be managed to ward off the threat of restrictions on their international operations.

The information revolution permits an increasing number of companies to engage in cross-border transactions. Even small U.S. enterprises will engage in electronic commerce in the future or collect information on EU residents via web sites. On account of their dependence on information and their participation in a globalizing economy, thousands of U.S. businesses, large and small, from sector to sector, are potentially subject to and affected by the EU directive. Ironically,

companies’ desire to increase revenue through trade and investment in the EU ultimately permits U.S. privacy advocates and regulators to use the attention given to U.S.–EU clashes over the directive to promote greater data privacy protection in the United States.

EU Market Clout. The authority of EU regulation is bolstered by EU market power. The EU’s huge internal market enables it to exercise considerable clout in the negotiation of rules—in particular, harmonizing rules—governing firm behavior. In pooling their sovereignty, EU member states now speak with a more powerful voice. The timing of the U.S. reaction to the threat of bans on data transfers from Europe demonstrates this. It was not until the directive went into effect that U.S. authorities drafted the Safe Harbor Principles and increased pressure on companies to raise their internal standards. It is the conjunction of state market power and high state standards that facilitates standards elsewhere to be ratcheted upward.

The U. S. handling of data privacy issues reflects Americans’ traditional distrust of a centralized government.

Data Privacy as a Luxury Good. Data privacy is arguably a luxury good, that is, a good whose demand increases disproportionately (compared with the demand for other goods) as income levels rise. Luxury goods are demanded more in wealthy jurisdictions, and wealthy jurisdictions are more likely to exercise market power, especially when they coordinate their efforts. They use their market power to achieve their domestic policy goals, in this case pressing for foreign protection of the privacy interests of their citizens.

Externalities. Data privacy policies have significant externalities. Data is collected and exploited by companies located in multiple jurisdictions about individuals residing in multiple jurisdictions, so that the regulatory policy of one jurisdiction affects constituents of others. For the EU’s data privacy policy to be effective, its

cross-border effects cannot be avoided. From the standpoint of the EU resident, under-regulation in the United States of data privacy protection affects the privacy interests of the EU as well as of the United States resident.

Constraints of Supranational Rules. International trade rules do not significantly constrain the EU’s extrajurisdictional reach. WTO rules, which otherwise limit a country’s ability to restrict imports and exports, provide for exceptions to address the externalities of data privacy practices and policies. The United States should only prevail in a WTO complaint if it could show that the EU targeted the United States or U.S.-owned companies in a discriminatory manner. As a result, trade liberalization rules do not relieve the pressure on the United States to effectively raise its data privacy standards. On the contrary, they constrain U.S. ability to retaliate. Without the constraint of “negative” supranational rules, positive harmonization is required to manage regulatory conflicts.

In short, the U.S.–EU dispute over data privacy protection is a story of foreign political pressure backed by foreign market power which, in turn, incites new domestic political and regulatory interactions and constrains domestic market practices. The nexus between data privacy protection and trade and investment liberalization is full of ironies. In this information-rich world, each time we consume, information about us is consumed. On the one hand, liberalized trade and investment brings us a greater variety of goods and services at lower prices. On the other hand, with it we may import foreign regulatory policies, including policies mandating how information about us is consumed.

For privacy advocates, globalization is both an opportunity and a threat. It is a threat because information about us can be more easily diffused throughout the world to jurisdictions with lower data privacy standards and then made available locally (including via the Internet) to those prying into our habits and homes. It is an opportunity because foreign laws can be used as leverage to force domestic regulators and businesses to raise privacy standards at home, wherever that home may be. How far U.S. businesses will go in implementing fair information practices remains an open question. Yet the directive has helped push them further than they would have otherwise gone. ■



Economic Outlook for 2000: A Return to Normalcy

By Donald A. Nichols

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The economy is following the trends identified in my last forecast, which was released in March 1999. The trade deficit has continued to worsen, inflation has gone up marginally, and the negative household saving rate has fallen even further. Manufacturing has been hurt by the collapsing trade deficit, and Wisconsin's dependence on manufacturing, combined with its shortage of available labor, has caused it to grow more slowly than the nation as a whole. While this configuration of forces is not sustainable on an indefinite basis, there is no reason that it needs to end in the year 2000.

The negative saving rate of American households suggests that they are no longer contributing strength to the stock market. Indeed, it is likely that it is the stock market that is supporting household spending. High stock prices, in turn, have been supported, at least in part, by the huge inflow of funds from abroad, which are financing the American trade deficit.

Following the Asian crisis of 1997, the world's economy entered an unusual phase in which the United States grew strongly while most other regions stagnated. As a result, U.S. exports fell sharply in 1998, and its imports rose sharply in early 1999. Meanwhile foreign investors placed huge volumes of funds into American securities because the risks of investing elsewhere increased markedly. This drove the dollar up, making life even more difficult for American producers.

At some date, we will see the unwinding of these forces. Recovery abroad will begin and foreign funds will start to flow out causing U.S. stock prices either to fall or to be supported by an unlikely increase in American saving. In either of these cases, the long-awaited slowdown in the American economy will finally take place. The question is whether a major unwinding of this kind will take place in the year

2000 or at some later time. At this date, the best bet is for a slow unwinding to begin soon, but not to get out of hand in early 2000.

The risk of financial collapse is much lower today than it was a year ago. Banking difficulties are in the process of being worked out in many countries, especially in Japan. While Japan's macroeconomic equilibrium remains precarious, most observers feel it is poised for growth. In support of this likelihood, dollars have been pouring into Japan seeking investment opportunities, and the yen has strengthened considerably.

**As the forecast of growth
abroad becomes
increasingly secure, foreign
currencies will strengthen,
and the weaker dollar will
make American exports
more competitive in world
markets.**

The year 2000 will differ from 1999 in that foreign economies will grow more strongly, the probability of inflation in the U.S. will increase, and interest rates are likely to be higher. The Y2K problem is unlikely to cause any major glitches to the economy's performance. About Y2K, Alan Greenspan has said that we have nothing to fear but fear itself. Most forecasters have come to agree that the most likely effect of the Y2K problem, barring a public panic, is a modest increase in inventory accumulation in the next few months,

with sales of Y2K-related products peaking in late December, followed by a slow first quarter as these inventories work through the household pipeline. The likelihood of panic is unknown, though some have suggested that a panic is more likely if there is no other thrilling news to grip the public's attention in the last two weeks of 1999. Any cub reporter told on December 26 to go out and find a few stores that have already run out of flashlight batteries is going to be successful, just as would be the case in any other week. But in late 1999, even a normal level of spot shortages can be turned into big news.

Recovery Abroad

The world's major economies have turned a corner and are unlikely to decline in the near future. Whether Europe or Japan grows strongly in 2000 is not as important to the outlook as the fact that they have stopped declining and that forces of growth are appearing. Their growth will begin a long process of recovery in the U.S. trade deficit, probably back to the levels seen just before the Asian financial collapse of August 1997. Certainly the current high level of the U.S. trade deficit cannot be sustained indefinitely. As the forecast of growth abroad becomes increasingly secure, foreign currencies will strengthen, and the weaker dollar will make American exports more competitive in world markets.

The U.S. trade deficit, which has been running at annual rates of over \$300 billion in recent months, should begin a turnaround in 2000. This is because the anticipated recovery abroad will bring with it an increased demand for American products. The weaker dollar will end the displacement of American products by cheaper foreign goods both in foreign and domestic markets. This means that manufacturing activity in the United States will end its recent decline and begin to recover from the unusual challenge it has faced in the last few years.

In recent years, exchange rates have fluctuated much more widely in response to short-term financial flows than to trade flows. Financial flows are much more difficult to predict than trade flows because they depend on investor psychology. Most recently an anticipated recovery of the Japanese economy has led to a huge flow



of currency into Japanese investments causing the value of the yen to increase (see figure 1). The Bank of Japan has intervened to restrain the increase in the value of the yen, but the yen is likely to remain strong for the foreseeable future. Other currency flows can crop up quickly in response to relatively small shocks. But the major forces under way indicate a likely recovery of the yen and the euro to levels that prevailed a few years ago. This is because the recovery in those economies is expected to reduce financial risk and to lead to increases in interest rates that make their asset markets more attractive than they have been recently.

The smaller Asian economies have already begun to recover. Korea in particular is doing well. The Asian Development Bank forecasts that Korea will grow by 8 percent in the coming year. The risk of collapse in these economies has fallen substantially, and this lessens the likelihood of worldwide financial panic. On the other hand, there has been no major change in international monetary institutions to curb the kind of financial flows that led to the Asian collapse two years ago. Because of this we may continue to witness some very large movements of exchange rates in response to seemingly small changes in underlying economic fundamentals.

Interest Rates in the United States

It remains to be seen how American investors will respond to higher interest

rates at home. The Federal Reserve will not be constrained from raising interest rates over the next year, as they were in 1998 and early 1999, when they feared that higher interest rates could exacerbate the strains caused by an overvalued dollar. Any hint of domestic inflation—or even of strength in the sectors that have led to inflation in the past—could lead to higher interest rates in the future, because higher rates could also help stabilize the dollar against further declines in value.

The Y2K problem is unlikely to cause any major glitches to the economy's performance.

That is, from now through the year 2000, higher interest rates could help solve both foreign and domestic problems at the same time, whereas in 1998 or early 1999, higher interest rates might have helped solve the domestic problem of an overheated economy but would have worsened the international problem of an overvalued dollar.

At this writing the Bank of Japan is asking the United States to intervene to help stop the strong recent appreciation of the yen. One standard way to stop such

an appreciation would be to raise U.S. interest rates.

The Economy Remains Vulnerable

An increase in interest rates will threaten the stock market. Because of the economy's increased dependence on the stock market to sustain consumer spending, any decline in stocks is likely to be accompanied by a decline in spending. Consumers are financing their spending with capital gains on stocks and with increased borrowing against the equity values of residences. This does not necessarily mean that second mortgages or mortgage refinancings are supporting household spending. The normal turnover of ownership of residences can be associated with increased mortgage holdings if the buyers take on mortgages that are larger than those being paid off by the sellers. When interest rates decline, a surge in mortgage borrowing has been associated with a surge in consumer spending in recent years.

The stock market has received important support from foreign investors in the last few years as the United States often seemed to be the only safe haven for investments. This source of support may be waning as investors regain confidence in markets abroad. U.S. stock prices may be vulnerable to a lack of support from abroad, in which case a decline in both the market and in consumer spending could cause a slowdown. The most recent survey of forecasters by the Philadelphia Federal Reserve Bank does not show much support for this possibility, however.

The Risk of Inflation

On the domestic front, inflation is more likely to rise in 2000 than it was in 1999. This too will increase the likelihood of the Fed raising rates. The increased risk of inflation is a result of a further tightening of labor markets, which will lead eventually to higher wages and to an increase in the prices of raw materials that will result from the weaker dollar and from the recovery abroad. Many raw materials prices are set in world markets. These prices have been very low in recent years because foreign demand has been weak. As foreign demand strengthens, materials prices will begin to increase.

Even the increase in the price of oil is due in part to the economic recovery and to the prospects of a further recovery. Except for a few brief periods, OPEC has

FIGURE 1

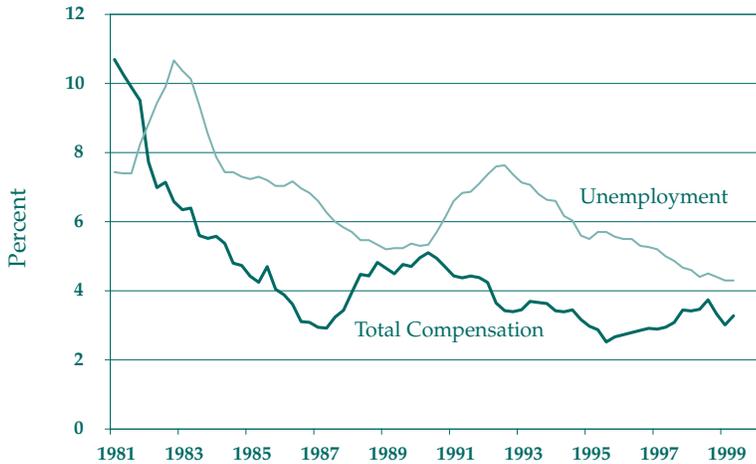
Yen Per Dollar





FIGURE 2

National Unemployment and Wage Inflation



found it difficult to allocate production quotas among its members in a way that encouraged sufficient cooperation for the cartel to raise prices. Whenever the cartel was successful in the past it was during a time of worldwide boom. It is easier to maintain a cartel in the face of rising demand than when sales are falling.

Every indication from the Federal Reserve is that they now view oil and food prices as being determined primarily by forces other than the level of economic activity. Hence the recent increase in oil

prices by itself is not a reason to expect interest rates to rise. But in the past, patience has quickly run out when the list of exceptions grew long. If we say there is no inflation except that caused by oil and food prices, and then we add inflation caused by worldwide increases in materials prices, and finally we add the increasing prices of imports, the overall inflation rate could move to such a great extent from these special factors that the Fed would act despite a lack of inflation in domestic wage rates and despite an

improvement in the economy's overall rate of productivity growth.

Wage Inflation

In the past, I have refused to give an inch to those who claimed that the inflationary tendencies of the U.S. economy had been lessened by its structural changes. All past relationships between inflation and economic activity seemed to me, if properly specified, to be just as strong in the 1990s as they had been in previous years.

Wage inflation in 1999, however, has been lower than these past relationships would predict. Figure 2 shows how wage inflation is less than would be predicted from the historical relationship between wages and unemployment. Only the future will tell if the lower level of wage inflation is a temporary aberration or if it is caused by some permanent change in the economy's structure. If it is found to be a result of a change in the economy's structure, it will be interesting to see if the change in structure is one involving a heightened level of productivity growth or simply an increase in competition from abroad.

It is interesting to note that the Index of Help Wanted Advertising indicates that the labor market is not as tight today as it has been at previous peaks in the business cycle (see figure 3). This index measures the tightness of the labor market from the perspective of job vacancies, and it suggests that the shortages faced by employers today are not as severe as at previous business cycle peaks when wage inflation has started to increase. The divergence of this indicator from its historical relation to the unemployment rate could have a variety of causes, among which could be that the growth of temporary help agencies. They have increased the efficiency with which unemployed workers are matched to job vacancies. It could also be because modern white collar workers are far more efficient at their own job searches than was the blue collar labor force of the past.

Wisconsin's Economy

The Wisconsin employment data are difficult to interpret at this date. Overall, employment growth in Wisconsin appears to have fallen well below employment growth in the nation as a whole. Employment growth over the most recent twelve-month period has

FIGURE 3

Help-wanted Index: Column Inches of Newspaper Advertising

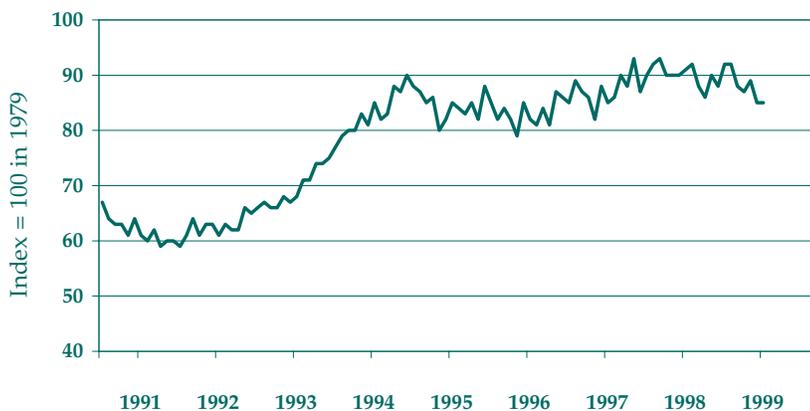
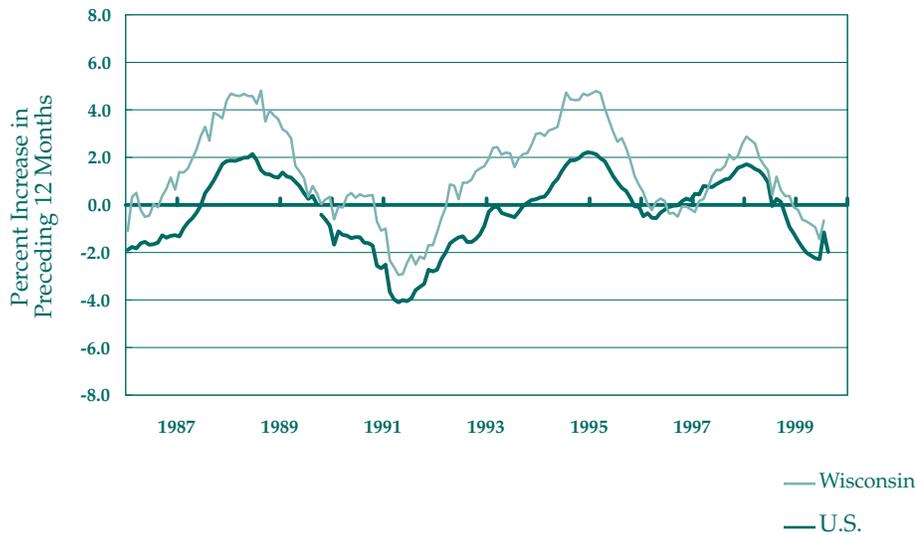




FIGURE 4

Growth in All Manufacturing Employment



been about 1 percent in Wisconsin while it has been about 2.3 percent in the nation as a whole.

Usually a shortfall of this magnitude would take place only if the Wisconsin economy suffered from some weakness that was not shared by the rest of the country. Because I have come to trust the employment data to provide the most accurate indication of Wisconsin's relative economic performance, I find the shortfall disturbing. However, I have been unable to find any confirming evidence of

weakness in other Wisconsin data, such as car sales or sales of new houses. Hence at this date, I attribute the weakness in Wisconsin's employment growth to a list of special factors rather than to a weakening local economy.

Part of Wisconsin's shortfall is due to its disproportionate dependence on manufacturing, a sector that has suffered at the national level (see figure 4). There is no evidence that Wisconsin's manufacturing sector has been hit harder than manufacturing elsewhere, but when

manufacturing weakens at the national level, the national weakness hits Wisconsin harder than it hits most states.

Another part of Wisconsin's shortfall is due to a shortage of workers, a force I have been noting for five years. Wisconsin's unemployment rate remains at this date a full percentage point below the national rate (see figure 5). If employment grows strongly at the national level, it is just impossible for Wisconsin to keep up. An unemployment rate of 3 percent cannot fall much further.

Another factor could be that Wisconsin's welfare reform programs were putting people to work well before the national programs were geared up. It is possible that some of the recent growth in employment in the rest of the nation reflects a force that caused Wisconsin's employment to grow strongly over a year ago.

Readers should also be cautioned that the local employment numbers have been subject to substantial revisions in the past and that next year, I might present a chart of Wisconsin's employment growth that looks quite different from the chart in this report that provides evidence of the shortfall.

The employment shortfall appears to be especially acute in two sectors—temporary help and eating and drinking places. Both of these sectors hire a disproportionate share of low-wage workers. If the labor force is incapable of further growth, these would be among the first sectors to experience a shortage of workers.

Conclusion

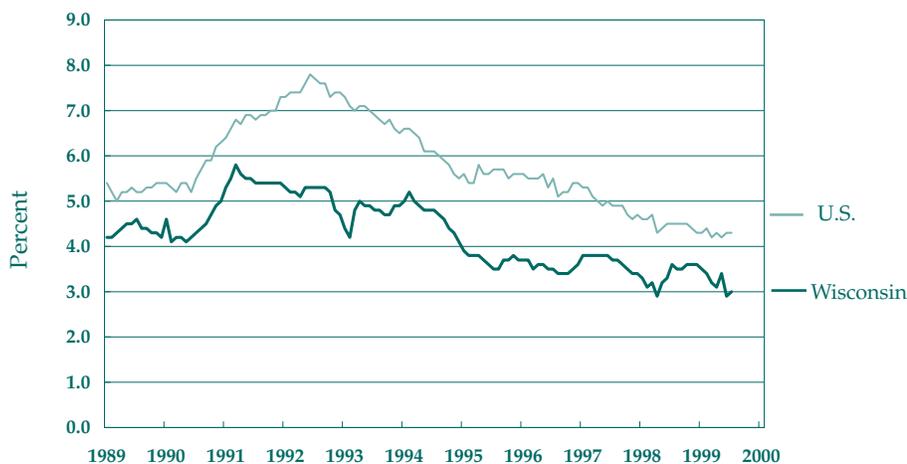
At the national level I anticipate growth to continue at a rate of 2.5 to 3 percent, and I expect Wisconsin's growth to be about one-half to three-quarters of a percent slower than that. This forecast assumes a continuation of recent economic trends, including the large trade deficit and the negative saving rate, with some moderation in residential construction.

I expect the overall inflation rate to pick up by a full percentage point in the coming year, with some of the increase due to an increase in wage inflation and some due to an increase in raw materials prices.

The higher inflation is likely to lead to higher interest rates, partly due to market forces and partly due to actions of the Federal Reserve.

FIGURE 5

Unemployment Rates





continued from page 12

observed as the MRA is removed as a “target” age of retirement. That is, as faculty must pay more attention to and are educated by their institutions about other retirement benefit provisions, retirement rates may rise among younger faculty. Robert Clark of North Carolina State University and his colleagues report higher rates of retirement among some younger people; the stability of mean ages of retirement even as some faculty delay retirement past age 70 imply increases in retirement rates at younger ages.

Whether a change in retirement age should be a concern to affected institutions depends on the teaching and research productivity of those who delay retirement. Clearly the academic enterprise is worse off if less productive faculty members continue past age 70 while those who are popular teachers and would otherwise publish and bring in grant money to support the research and teaching enterprise retire early.

Although our study was of the effect of changing the MRA from 65 to 70, our findings anticipate many of those of uncapping. Reports from both the National Research Council’s Committee on Mandatory Retirement in Higher Education and the Project on Faculty Retirement concluded that the increase in the number extending beyond 70 would be small, that those who did extend would tend to be the most productive, and that the private research universities whose average age of retirement was highest were most able to afford well targeted early retirement programs.

The studies in the volume in which this article appears (see introductory note) show that a small number have continued past age 70 while most faculty retire earlier. Indeed, both the data on the age distribution at retirement and on the unchanged mean age of retirement after uncapping imply a spreading of retirement age as faculty take other factors into account than the targeted MRA as they plan their retirement. Recently obtained data from the University of Wisconsin-Madison campus, which had its MRA eliminated during the exempt period, showed a slight increase in retirement numbers and a decline in average age of retirement from age 66.0 to 65.3 after its uncapping.

Conclusions

The challenge in assessing the effect of changes in one retirement policy on

retirement timing, faculty age distributions, hiring options, and salary costs is separating its effects from other demographic and economic constraints that would have operated even without that policy change to alter the faculty age distribution and raise institutional costs. The strength of our 1980-81 study lies in attempting to understand the interplay between faculty decisions to retire and the institutionally provided benefits they expect to receive. Unfortunately, higher education has never launched a long-term effort to collect those data necessary to understand how and why retirement decisions of faculty members have changed over time and in response to political, institutional and personal factors. Large national data sets provide these data for the general population (e.g., the Health and Retirement Survey) but contain only a small number of faculty members. Institutional employment data do not provide the rich individual and social context within which these decisions are made.

Because private and public institutions differ so substantially, an analysis that is confined to one or the other sector will leave important questions unanswered. As it was, the institutions taking advantage of the exemption were largely private colleges and universities, and private research universities in particular. It may be possible to examine the determinants of faculty retirement in those institutions and even their responses to early retirement incentives, but an important question remains: How different is the experience at these institutions from that of public institutions, which for the most part did not take advantage of the MRA exemption? Similarly, looking only at the experience of private research universities, about which there is the greatest concern, one can see only part of the picture. One of our strongest conclusions is that we need better, industry-wide data on faculty in higher education.

The measured effects of uncapping are mixed, a result anticipated in the studies of both the 1978 and 1986 ADEA amendments; although some institutions saw increases in the number of faculty working up to age 70, the numbers were small, and many institutions saw no major change in retirement rates. Our own analysis anticipated what happened—that the major private research institutions

were more likely to find their faculty delaying retirements. But these were precisely those institutions in which even prior to 1978 faculty were most likely to delay retirement, and apparently not simply because of defined-benefit coverage, but because of some combination of factors that made delayed retirement more attractive to these faculty.

This is good news if delayed retirement was and continues to be more likely because of the institutions’ well-targeted (even if unintentional) incentives to continue productive teaching and research. Even if the news is not all good for these institutions, it is clearly not justified that broad changes be made in policies, such as major changes in pension plans, until it is clear precisely what are the factors leading to delayed retirements and their productivity consequences. Our study supports the development of options that allow faculty to move into part-time assignments that permit them to continue their research and in some cases limited teaching activity.

Other researchers studying this topic suggest that other economic and noneconomic factors are almost certain to dominate the effects of the relatively small numbers of faculty continuing to teach beyond age 70. We suggest further research on understanding the role and potential impact of these non-pension benefits on retirement behavior. In addition, as our simulations show, at the institutional level the impact of other variables is considerable. In particular, enrollment levels and the revenues they produce, whether through tuition or public subsidies, fluctuate considerably from year to year. The number of faculty on the payroll varies from year to year because of unexpected resignations and less than perfect timing in hiring replacements. Research funding that supports faculty salaries also varies.

In short, the fiscal and other effects of faculty continuing until age 70 and beyond appear to be relatively small when compared with the impact of other forces. This conclusion does not suggest that “at the margin” the continuation of faculty beyond age 70 is of no concern. But with unexpected variations on so many margins, this one is hardly critical and should not be used to divert attention of academe from more critical retirement policy issues. ■



continued from page 8

gaps among people have narrowed, the growth in earnings inequality has slowed, and the poverty rate is edging down.

As we have seen, it was not always so. During the 1970s and 1980s, the poverty rate seemed to have bottomed out, in spite of economic growth. Earnings and income inequality rose, overall earnings stagnated, and corporate restructuring left many feeling insecure. While people at the top of the distribution prospered, folks in the bottom half did not. The nation substituted faith in collective action for a return to a market philosophy and a message of self-reliance that accompanies it.

Public concern and intervention waned, and this offset to the vagaries of the market was blunted; much of the reduction in government has been targeted on those with low skills and low incomes. At the end of the 1980s, homelessness was a national issue, crime and drugs were seen as undermining the nation, and schools and the health care system were generally viewed as broken. The age of self-reliance seemed unwilling to muster the collective action necessary to address these concerns effectively. It took just a few years of growth and prosperity to suppress these concerns and to sweep them off the table.

Yet the current prosperity is fragile. Maybe we have entered a new era of sustained growth that will truly counter

this legacy, but then again probably we haven't. If recession strikes, these old problems will again be with us, and because of an eroded social support system they may return with some vengeance. As Frank Levy of the Massachusetts Institute of Technology has effectively reminded us, continued national progress rests on three variables: "the rate of productivity growth, the economy's level of skill bias, and the quality of our equalizing institutions." Each of us has our own best guesses regarding future trends in the nation's productivity, and the degree to which new technology will work to the disadvantage of those without skills. Unfortunately, no one can tell us whose forecast is most reliable.

The tale of the last 40 years, however, cannot give us comfort regarding the strength of the nation's equalizing institutions. Indeed, trends in educational policy, in retirement policy, in the strength of worker organizations (especially relative to the economic and political power of shareholders), in the financing of higher education, in the access to health care, and in the erosion of the nation's safety net all testify to the prevailing view that each family must rely on its own resources, that self-reliance has replaced social support. When things are "as good as they get" these trends become camouflaged, yet they are real and ready to raise their head if given a chance. If the economy falters, the poor and

the unskilled are not likely to fare well.

If there is any truth in this observation, then the nation needs now to place on its agenda the strengthening of institutions and policies that are able to cushion the impact of a reversal of fortunes on those who are already in the bottom tail of the distribution. Such institutions are "social insurance" writ large.

Proposals for the restructuring or creation of such institutions are not lacking, and include labor market reforms (in the form of employee- and employer-based work subsidies, or public employment measures), enforcement of support by absent parents for their own children, expansion of work-oriented income support (e.g., the Earned Income Tax Credit or child care subsidies), the subsidization of asset accumulation for low income families, increased investments in early childhood, nontraditional training programs, and the extension of medical care support for those unable to pay for it on their own.

The absence of consensus among experts regarding the most promising among these options is not surprising, and is no different than it was in the 1960s. What is different—and dangerous—is the apparent national disinterest with this erosion of its equalizing institutions, and the failure of those who are concerned to place the issue back on the nation's table. ■

The LaFollette Policy Report

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