

the economics of **AGING**

third edition

james h. schulz

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# Preface

Readers of the first two editions of *The Economics of Aging* will notice some changes in the third edition. Major portions of the book have been changed and updated. More attention is given to the growing economic impact of expenditures for elderly programs and to the so-called dependency burden. The frequently heard argument that the elderly are no longer poor is carefully examined in light of new data. Recent changes in the social security law are incorporated, including the major amendments of 1983, and changes in the social security pension age are discussed. A new chapter, "Health, Disability, and SSI Benefits" (Chapter 7), has been added, expanding the discussion of these topics. The chapter on social security financing has been updated to reflect recent developments, and both short-term and long-term financing receive extensive consideration.

There have also been considerable shifting of topics and changes in the organization of chapters. The new order of presentation groups complementary topics closer together and should make the material easier to follow. And each chapter now ends with a list of chapter highlights and suggested additional readings.

The glossary of terms has been expanded to assist readers unfamiliar with economic terminology. Glossary terms appear in bold face type upon first appearance in the text.

Policy makers and the elderly themselves generally agree that economic security in old age is one of the most important problems needing a solution. Yet, as in other areas of knowledge, misconceptions abound. Most aged are not poor; they are not the group most seriously hurt by inflation; they have not been *forced* to retire. Social Security is not bankrupt.

We do not know the answers to all the questions raised concerning the economic situation of the aged. However, this book attempts to present a wide range of existing knowledge, which permits a more sophisticated view of the many issues and which, in some cases, challenges the conventional wisdom.

I have tried to cover technical topics in a relatively nontechnical and concise manner. Inevitably, a lot of the complexities and much of the existing literature could not be discussed. However, the suggested readings at the end of each chapter will be useful to those readers seeking to extend their knowledge on particular issues. Again, however, I have tried to avoid highly technical works.

Some readers may be surprised by the proportion of the book devoted to pension issues (four chapters). To me, however, the key to understanding the current and future economic status of the aged is an understanding of private and public pension programs. Therefore, I have devoted considerable space in the book to describing these programs and, more importantly, to discussing their economic impact on the younger and older populations.

I first became interested in the economics of aging when some years ago I had the opportunity to ask one of the most knowledgeable persons in the aging field, Clark Tibbitts, "What have economists contributed to our knowledge about growing old?" His answer and challenge to a young graduate student who was then searching for a dissertation topic—"Why don't you find out?"—triggered a sequence of events of which this book is a product. It is appropriate then that the book begins again with an introduction by Clark Tibbitts, a person who has dedicated a major portion of his life to improving the social and economic welfare of older persons.

The number of people who have contributed to this book over the years with their suggested changes, corrections, and useful insights has now become too large to list each individually. I would, however, like to acknowledge the following third edition reviewers: Elizabeth Elmore, Stockton State College; Charles H. Hawkins, Central Washington University; Harold L. Orbach, Kansas State University; and Herbert S. Parnes, Emeritus, Ohio State University.

I also wish to explicitly thank my family for their support and understanding. As I pushed hard to finish the third edition before going off to Africa in 1983, it was their cooperation and enthusiasm that helped keep me going to meet the deadline.

Finally, my sincere thanks to Margaret Stubbs for her research and typing assistance for all three editions.

James H. Schulz  
Waltham, Massachusetts

# Introduction

by Clark Tibbitts

The appearance of three editions of *The Economics of Aging* within a period of eight years testifies to the dynamic nature of the subject and to its cogency for students, practitioners, policy makers, and researchers in the field of gerontology and its underlying disciplines. The invitation to contribute an introduction to this new and extensively revised edition affords me the opportunity to reflect on some of the principal developments that have taken place in the field during the more than half century of my working life.

My first awareness of the economics of aging came to me during my adolescent years in Chicago. The United Charities of Chicago used to conduct an annual “tag day” to raise funds for needy older people in the Chicago area and help support the county home for the destitute. Hundreds of volunteers stationed on busy streets invited pedestrians to drop money into a hand-held container; contributors were awarded a stringed tag to be worn for the day, identifying them as “givers.”

My initial professional experience with the economics of aging came during the Great Depression, when workers by the million were unemployed, as the saying went, “through no fault of their own”; when thousands of businesses and banks were failing; and when farms were being foreclosed in similar numbers. President Hoover attempted to assure the country that the return to prosperity was “just around the corner” and that there would soon be “a chicken in every pot.” He backed his optimism with firm resolve, sending General Douglas MacArthur on horseback to break up the March of the Unemployed on the Washington Capitol.

Hoover’s obstinancy helped elect Franklin Roosevelt to the presidency. Taking office in March, 1933, Roosevelt forthwith launched a constellation of alphabet agencies—NRA, FERA, PNA, WPA, FCA, HOLC, AAA, FmHA, PHA, and CCC—to give depressed Americans a New Deal. Every agency addressed the economics of aging in one way or another.

Restless to have a part in the precedent-breaking government actions, I joined the research unit of the Federal Emergency Relief Administration (FERA) and shortly thereafter the Public Health Service's National Health Inventory, funded by the Works Progress Administration (WPA). The two experiences revealed that one-fourth of all workers and one-half of *older* workers were unemployed and that chronic illness and difficulty in obtaining medical care were especially prevalent among older people, particularly those with low incomes.

I therefore reacted with enthusiasm to President Roosevelt's appointment of the Committee on Economic Security under the chairmanship of Frances Perkins. The committee drew up specifications for an old age insurance program (OASI), modified before it became operative to include survivors; a program of old age assistance (OAA) to provide income to the needy while the OASI program was building an operating reserve; and an unemployment compensation program for short-term financial assistance. As Professor Schulz discusses in his book, the objectives of the OASI program were both to remove older workers from the work force and to assist the states in providing income to the elderly needy during a period of dire economic vulnerability. The means-tested OAA program served millions not covered by OASI and was replaced by the supplemental security income program (SSI) in 1974.

I agreed with the late Professor Fred W. Cottrell's appraisal that enactment of this social security legislation represented the most radical extension of government into the private lives of citizens ever taken by the American government. The supplemental security income program (SSI), which superseded OAA in 1974, was also a dramatic and far-reaching development. The coverage it provides closes gaps left by the other financial aid programs and attempts to assure that no older person today will be without at least a modicum of income. Responsibility for management of SSI was assigned to the Social Security Administration to help remove the stigma attached to receipt of noncontributory assistance.

Social security was designed originally to provide only a modest floor of income. The assumption was that additional support required to sustain an adequate level of living would be available from earnings, personal savings, pensions, and gifts from adult children.

As this book explains in detail, the assumption proved to be quite erroneous; social security has achieved a much larger role than originally anticipated. The older population was increasing rapidly, doubling between 1900 and 1930 and again between 1930 and 1950. The transformation to a mechanized, industrial economy led many employers to divest themselves of older workers in favor of the plentiful supply of youth eager for jobs. Private pensions were few, and many adults were unable to support both young families and older parents as well. I was gratified, therefore, to witness the amendments that liberalized social security by broadening coverage, expanding protection, and raising benefit levels.

I was equally pleased with the later emergence of private pension plans that raised many retirement incomes above the basic social security levels. The

emerging pension movement was advanced significantly during World War II, when employers used the promise of pensions to recruit urgently needed workers. Growth continued when the Supreme Court sanctioned (1948–49) organized labor's effort to include pensions—rationalized as deferred wages—in collective bargaining. Private pension systems now cover about half of all private wage and salary workers.

Enactment of legislation in 1965 for establishment of the Medicare–Medicaid programs represented to me a third major development in the economics of aging during the period. The Committee on Economic Security in 1935 omitted health insurance from its recommendations on the assumption that it could be obtained easily after the basic social security program had been put in place. Instead, organized medicine, the life insurance industry, and others opposed to further government intervention into affairs of the private sector delayed health insurance legislation for 30 years.

As I have observed it, one of the most compelling issues in the economics of aging over the century has been that of achieving a harmonious relationship between chronological age, employability, and pension eligibility. As noted above, employers have responded to our transformation into an industrial economy by replacing older workers with what they presumed to be healthier, stronger, physically and mentally more agile youth. At the beginning of this century, Sir William Osler, a Canadian physician, rationalized management's position when he stated that men past 40 were comparatively useless and those past 60 were absolutely useless. Both Theodore and Franklin Roosevelt disparaged the physical and intellectual performances of those who had survived the middle years. The social security eligibility age of 65, reflecting a compromise between reality and affordability, was adopted by employers as the age for compulsory retirement, with additional inducements for even earlier withdrawal.

Most of us teaching, doing research, and thinking about aging policy rebelled at the prejudice, inequity, and costs of this negative view of older people. Supported by Department of Labor and other studies of older worker performance, gerontologists saw compulsory retirement at age 65 or earlier to be wasteful of experienced manpower—manpower demonstrated to be careful, conscientious, loyal, and reliable.

A succession of national conferences on aging held strongly to this view. By 1967 older worker advocates were able to persuade the Congress to pass the Age Discrimination in Employment Act prohibiting discrimination in employment after age 40.

As I look back over the years, I am pleased by the variety of actions that have been taken to protect the income and employment of older persons. Federal and state income taxes provide for liberal personal exemptions; most states offer partial property tax exemptions for the elderly. Federal–state community programs offer food stamps, group and home-delivered meals, reduced local transportation fares, special housing (often subsidized), assistance with legal problems, and long-term care options.

In *The Economics of Aging* Professor Schulz has shown that the United States has gone far toward assuring older people opportunity to continue to en-



joy the amenities and security of living the country seeks for all of its citizens. Government programs have laid the foundation, and the private sector has played a key complementary role. But, as I have emphasized in my writings over the years, these efforts have not so much substituted for the traditional activities of individuals and families as they have enhanced them and made them more viable. To my mind, confronting the challenges of aging in America, including the *economics* of aging, is truly a cooperative endeavor among various groups and institutions. And that is the way it should be in today's enlightened society.

*Editor's note: Clark Tibbitts retired in 1983, leaving the U.S. Administration on Aging after working 53 years in jobs related to aging. He was 80 years old at the time.*

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# Chapter One

## *Changing Populations and Retirement Expectations*

Not too many years ago it was relatively easy to write about the economic situation of the elderly population. All one needed to do was cite statistics that confirmed what everyone knew from either personal experience or observation. For years now everyone has known that most of the elderly have suffered from serious economic deprivation—that their incomes were inadequate, that inflation exacerbated the situation by reducing real incomes and eroding savings, and that the aged were one of the largest poverty groups in the country.

Today the situation is much more complex, due in large part to our nation's very positive response to the economic plight of the elderly. During the past few decades major breakthroughs have occurred in the development of private and public programs to deal with the economic problems of old age:

1. Over the past fifteen years, social security old age benefits have been increased by almost 200 percent, significantly faster than inflation over the same period.
2. Private pension programs have spread throughout industry and have grown rapidly—with dramatic increases in benefit levels.
3. Medicare and Medicaid were legislated—currently providing over \$50 billion a year in benefits to older persons.
4. Property tax relief laws have been legislated in all our states.
5. Old age assistance has been abolished and a new Supplemental Security Income Program (SSI) has taken its place. This program roughly doubled the number of low income elderly eligible for income supplementation. And it raised benefit levels in 24 states above the previous levels of old age assistance—in some cases dramatically. In addition, a national food stamp program helps low income people of all ages.

Despite the economic problems that remain (which will be discussed later in this book), we must not lose sight of the important economic gains that have been made. Dramatic changes have occurred in the levels of income provided older persons, especially from public and private pensions. Consequently, there has been a significant improvement in the general economic status of this group—traditionally viewed as poverty stricken. In fact, a recent study by Timothy Smeeding (1982) finds that if both money and in-kind income (defined

on p. 31) are counted, few elderly currently fall below the official government “poverty level.” In 1979, counting only money income, the poverty rate was 14.7 percent. However, Smeeding estimates that only about 5 percent fell below the poverty level, if in-kind benefits related to food, housing, and medical care are taken into account.

The methodology used to make these estimates is controversial, and hence not everyone agrees with the results. The Smeeding findings serve to dramatize, however, the undisputed progress that has been made in raising many from the ranks of the “most poor” to the ranks of the “near poor.”\*

So rapid and so great has been this improvement in the welfare of the aged that assessments of their condition have not kept pace with progress. Not only the general public but also many professionals concerned with the problems of the elderly have a serious misconception regarding the current economic situation of the aged. A study by Erdman Palmore (1977) reports that about one-half of the graduate students and faculty in the field of human development and aging at two prominent universities did not recognize as an *incorrect* statement the true-false quiz question: “The majority of old people have incomes below the poverty level (as defined by the federal government).” In contrast, these same students and faculty answered correctly about 90 percent of the other questions in the aging quiz covering twenty-four other areas of knowledge about older persons.

There is no doubt that many people are unaware of the rapidly improving economic status of the aged in America. Still fewer have thought about its implications for policy on the aging. Given, for example, the projected shortfall of the social security system in meeting its projected obligations (see Chapter 6), this news of a greatly improved economic situation for the aged is a development to be welcomed. As various ways of raising additional revenues for the system are considered, it is certainly heartening to hear that older people today are economically much better off than they were little more than a decade ago.

The decline in the seriousness of the elderly’s economic problems means that the task of helping the aged may not need to be as high on the social agenda as in prior years. In fact, given the rising costs of providing for the aged, some people have begun to argue that we have already gone too far.

### **Aged Programs, the Federal Budget, and the Elderly**

*The significant, semi-hidden story in the . . . federal budget is that America’s public resources are increasingly being mortgaged for the use of a single group within our country: the elderly.*

The above quote is similar to many statements made in recent years. But it was voiced over a decade ago by columnist David Broder (1973), writing in the

\*Whether the progress is sufficient is a different question. In the next chapter we discuss, for example, the appropriateness of the official poverty index.

*Washington Post*. Broder's article was one of the first assessments to raise questions about growing federal expenditures for the elderly.

In 1978, Health, Education and Welfare Secretary Joseph A. Califano, Jr., became the first cabinet secretary to publicize the problem of rising federal expenditures for the elderly. He estimated that \$112 billion was paid out that year by federal programs assisting the elderly. And he projected that these expenditures would rise from 24 percent of the federal budget in 1978 to 40 percent in the early part of the twenty-first century (Califano, 1979).

In 1980, a *Forbes* magazine article characterized the growing media attention given to the issue. A feature article titled "The Old Folks" was headlined: "The myth is that they're sunk in poverty. The reality is that they're living well. The trouble is there are too many of them—God bless 'em" (Flint, 1980).

More recently, Barbara Boyle Torrey (1982), an economist in the federal government's Office of Management and Budget, summarized the issue in this way:

*The traditional tradeoff between guns and butter may in the future be better characterized as a tradeoff between guns and canes. The increase in the older population is likely to generate an increasingly powerful fiscal interest group, concentrating its attention on the federal government. The estimated outlay increases that could be expected in the future because of the increases in the older population are not insupportable. . . . It does, however, represent a clear shift in future priorities for the federal government that will need to be confronted.*

When the Reagan Administration took office in 1981, the aged felt the effects of the first broad action taken to cut back expenditures for the elderly. President Reagan's budget request for 1983 called for \$6.5 billion less expenditures for aged programs than would have occurred under pre-Reagan policies. Ultimately \$5.2 billion in cuts, over half in the Medicare programs, was legislated. In a review of both these spending decreases and the tax reductions occurring during this period, Storey (1983) concludes that the impacts varied greatly by level of income. The well-to-do aged received substantial tax cuts and escaped major benefit cuts; the middle-income aged were helped a little by tax cuts but were more affected by benefit cuts; and the low-income aged received no tax-cut benefits and bore the brunt of many of the largest spending cuts. "The net result of the policy changes made during the past 27 months [1981–83] has been to squeeze the resources available to the neediest among our Nation's elderly populations" (Storey, 1983).

According to political scientist Robert Binstock, the stereotypes that the aged are poor, frail, relatively impotent as a political force, and more deserving of help than some other groups in poverty have given way to a new set of axioms. The aged are increasingly perceived as relatively well-off and a potent political force that will soon pose an unsustainable burden on the economy. "These new axioms regarding older persons have provided the foundation for the emergence of the aged as scapegoat in American society. That is, the aged are bearing the blame for a variety of economic and political frustrations" (Binstock, 1983).

Have we collectively done enough for the elderly? Or have we, perhaps, done too much? To answer these questions we can no longer generalize about the economic situation of all the aged as one group. Instead we must look at the multitude of programs for the elderly and analyze their impact on various subgroups of the elderly population. We must distinguish, for example, between the very old aged (the “vulnerable aged”) and those just retiring, between widowed and married women, and between those families with two or more pensions and those with only social security.

In the chapters to follow we will survey the major economic changes that have occurred among various groups of the aged. But before we do this, it is important to discuss the changes in retirement expectations that have occurred in American society and the important demographic shifts that are now occurring.

### The Right to Retire

As observed by Donahue, Orbach, and Pollak (1960), “retirement is a phenomenon of modern industrial society. . . . The older people of previous societies were not retired persons; there was no retirement role.” A number of developments, however, changed this.

Even *before* public and private pension systems were widely established, large numbers of older persons were not in the labor force. As early as 1900, for example, almost one-third of all men age 65 and over were “retired,” in large part because of health problems. Prior to the institution of **pension\*** systems, however, older persons not in the labor force had to rely on their own (often meager) resources, help from relatives, or public and private charity. Over the years recognition spread that complete reliance on these sources of old age support was unsatisfactory. *Public pensions were, in part, a reaction to the need of more rational support mechanisms for older persons unable to work.*

Industrialization created a new problem. In contrast to the farm, where people could almost always “work” (even if it was at reduced levels), industry was characterized by a large amount of job insecurity. Recurrent **recessions** and **depressions** and shifts in employment opportunities created competition for the available jobs. *Thus, another motivation for establishing pensions was to encourage older workers to leave the work force and create jobs for younger workers.*

But probably most important of all, industrial growth—fueled by rapid technological change—resulted in vast increases in economic output. As we discuss at length in Chapter 3, economic growth provides an expanding option for greater leisure with a simultaneous increase in living standards. That is, the rapid economic growth of the twentieth century made it possible to more easily support older people who could not (or did not wish to) work. Retirement became economically feasible.

\*Many technical terms appearing in the text are defined or explained in a glossary at the back of the book. Terms in the glossary appear in boldface type the first time they appear in the text and, in the case of very important terms, at first appearance in subsequent chapters.



Thus, we see the institutionalization of retirement arising as a result of and reaction to (a) the needs of large numbers of elderly unable to work, (b) short-run fluctuations in employment opportunities for both the young and the old, and (c) expanding economic resources over the long run. Pension programs were developed that “provided compensation based upon years of service rather than upon need per se. They were to emerge as an ‘earned right’ and were to become instrumental in defining a retirement status as appropriate for the older worker” (Friedman and Orbach, 1974).

### Changing Expectations

As just indicated, until recently retirement meant dependency—on relatives, friends, private charity, or government welfare. Indications are that many elderly tended to accept a subsistence lifestyle as the best that could be expected in old age. Attitudinal surveys have found, for example, that despite their relatively low economic status, very *high* proportions of the elderly viewed their economic situation as satisfactory and not below their expectations.\*

In earlier periods, studies did find that many people *close to* retirement viewed the approaching period negatively. According to Friedman and Orbach (1974), “The widespread opposition to retirement reported in studies during the 1940s and the early 1950s reflected an overwhelming concern over the consequences of serious deprivation associated with retirement.” More recent studies, however, have found attitudes toward retirement becoming more positive as the economics of retirement have improved. Studies by Shanas (1977) and Atchley and Robinson (1982), for example, found generally positive attitudes toward retirement both before and after retirement.

Thus, retirement expectations are changing. In part, this has resulted from increases in living standards at all ages. More importantly, the development of pension programs and the continuous improvement in their provisions have given the elderly increasing independence and for the first time placed a comfortable standard of living within the reach of many. Increasing pension benefits and pension coverage seem to stimulate demands for still higher retirement incomes.

### Aging Populations

At the same time that retirement income expectations are changing, we are witnessing an aging of populations around the world. Demographers classify countries into “young,” “mature,” and “aged” populations according to the proportion of population age 65 and over. Cowgill and Holmes (1970) have suggested that countries with 4 to 6 percent aged should be classified as young, 7 to

\*See, for example, the report of Louis Harris and Associates listed in the Suggested Readings at the end of this chapter. For a conceptual framework that incorporates the notion of relative deprivation to help explain the perceived financial adequacy among the elderly, see Liang and Fairchild (1979).