Volume Title: The Economics of Aging

Volume Author/Editor: David A. Wise, editor

Volume Publisher: University of Chicago Press

Volume ISBN: 0-226-90295-1

Volume URL: http://www.nber.org/books/wise89-1

Conference Date: March 19-22, 1987

Publication Date: 1989

Chapter Title: Overview

Chapter Author: David A. Wise

Chapter URL: http://www.nber.org/chapters/c11576

Chapter pages in book: (p. 1 - 8)

Overview

David A. Wise

Increasing longevity is changing every aspect of American life. An older population and longer individual life spans present the most important public policy issues that our society must address. In particular, an aging population raises important concerns about the future well-being of the elderly. The issues highlight the important interactions between demography, health, and economics. How many years Americans work, where and how they live, how well they live, and the kind and amount of health care they receive are all critical questions.

A possibly unforeseen drawback of living longer is that the proportion of one's life that is spent working may decline. If so, each year's earnings while in the labor force must support more years of health care and other needs while out of the labor force. The fact that Americans are living longer, and possibly healthier lives, but leaving the labor force at younger ages has far-reaching implications for the elderly. Not only will there be fewer young persons to support a larger number of elderly, but if current trends continue, a smaller fraction of one's lifetime will be spent working, further limiting the ability of the young to support the old. If policies are adopted to encourage later retirement, which of them would make a difference? What factors affect the age of retirement?

A fundamental determinant of the well-being of the elderly is financial status. Labor market behavior, housing choices, health—all contribute to financial status. Yet some of the critical determinants of the financial status of the elderly are not well understood. Nor are the determinants of the effects of financial status on health status, housing choices, and labor force participation.

This volume contains papers presented at an NBER conference on The Economics of Aging, held in New Orleans in March 1987. The conference was part of NBER's Project on the Economics of Aging. The goal of the project is to further our understanding of both the determinants of the economic well-being and the health status of the elderly, and the consequences for the elderly and for the population-at-large of an increasingly older population with longer individual life spans. The papers in this volume may be grouped into four areas: (1) housing, living arrangements, and family support; (2) labor force participation and retirement; (3) the economics of health and health care; and (4) financial status. Each of the papers is summarized briefly here.

Housing, Living Arrangements, and Family Support

The savings of a large proportion of the elderly are primarily in the form of housing. The life-cycle theory of consumption would suggest, therefore, that many older persons would reduce housing wealth as they age in order to maintain consumption levels. It is also hypothesized that many elderly are in need of free funds and would like to divest themselves of housing wealth to increase consumption in other forms, were it not for the large transaction costs, both economic and psychic, of moving from one dwelling to another. Both hypotheses are brought into question in papers by Daniel McFadden and Jonathan Feinstein on "The Dynamics of Housing Demand by the Elderly: Wealth, Cash Flow, and Demographic Effects" and by Steven Venti and David Wise on "Aging, Moving, and Housing Wealth." Although the papers were written independently, they use similar methods and reach similar conclusions. The goal of both papers is to study the impact of diverse social and economic variables on the housing decisions of the elderly and, thereby, to isolate the primary facts with which policy must contend. Both papers focus on two aspects of the housing choices of the elderly: (1) the decision to move; and (2) having chosen to move, whether to increase or decrease housing equity and/or annual housing expenses, like mortgage payments and heating. Feinstein and McFadden find that higher satisfaction with current housing is associated with lower mobility and with less downsizing. They conclude that this finding and others call into question the life-cycle model as traditionally formulated. In addition, they find only weak evidence that liquidity constraints affect the housing conditions of the elderly, a result which they conclude is consistent with the apparent lack of enthusiasm among elderly homeowners for reverse annuity mortgages. Their analysis also reveals a strong relationship between retirement and changes in family composition on the one hand and housing mobility on the other.

Venti and Wise confirm that families with high incomes typically also have high housing wealth and that families with low incomes typically have low housing wealth. Thus, they conclude that the potential for a reverse mortgage scheme to increase the consumption of the low-income elderly is limited. They find that families who have high incomes but little housing equity are somewhat more likely to move than families who have low incomes but substantial housing equity—those who are most likely to be liquidity constrained. Their analysis also reveals that the elderly who move are as likely to increase as to decrease housing equity. They also find that the typical mover is not liquidity constrained, and that the economic and psychic costs of moving are apparently not major reasons that the elderly fail to reduce housing equity as they age. They conclude that the absence of a well-developed market for reverse mortgages can apparently be explained by a lack of demand for these financial instruments. Finally, like Feldstein and McFadden, Venti and Wise also find a substantial relationship between retirement and changes in family composition on the one hand and housing mobility on the other.

Similar questions are also addressed by Konrad Stahl in "Housing Patterns and Mobility of the Aged: The United States and West Germany." The age distribution of the West German population today is very similar to the distribution predicted for the United States in the year 2000. His analysis is based on the U.S. Annual Housing Survey for 1978 and the West German 1 Percent Housing Sample for 1978. Stahl finds that in both West Germany and the United States moving is associated with substantial increases in housing-cost–to–income ratios. This is consistent with the findings of Feinstein and McFadden and of Venti and Wise. On the other hand, he finds that consumption of housing services, measured by rooms per family member, declines when the elderly move. This is true in both Germany and in the United States. He also concludes that the potential for adjustment in housing consumption by moving is much greater in the United States than in Germany, since elderly Americans are approximately four times as likely to move as their German counterparts. Finally, Stahl concludes that a strong impediment to mobility in Germany is the apparent rent advantage given to sitting tenants. They typically must pay substantially more for rental housing if they move. Venti and Wise report a similar finding for the United States.

In "Household Dissolution and the Choice of Alternative Living Arrangements among Elderly Americans," Axel Börsch-Supan studies the economic and demographic determinants of the decision to live independently or in a shared accommodation. An important aspect of his work is the decomposition of households into separate family nuclei. He finds that approximately one-third of elderly family nuclei share housing. While this proportion has increased among the general population in the early 1980s, it has decreased among elderly Americans.

More than 70 percent of elderly nuclei who share housing live with their adult children. In most of these cases, the parents head the common household. Among these two-generation households, between 1974 and 1983 an increasing percentage were headed by the parent generation rather than the adult children. He speculates that this development can be attributed to the increasing difficulty of finding affordable housing for first-time home buyers. Children who "take in" their parents have about twice the income level of the average second-generation (children) nuclei family. Finally, he concludes that the choice of living arrangements is determined primarily by demographic variables, not economic factors like income or prices.

Laurence Kotlikoff and John Morris are undertaking a study of the extended family through a special survey sponsored by the NBER and the Hebrew Rehabilitation Center for the Aged. The survey will collect information on children of the elderly residing in Massachusetts. Ultimately, the survey will provide a unique source of information about the behavior of the extended family. Preliminary findings from the survey are reported in the paper, "How Much Care Do the Aged Receive from Their Children? A Bimodal Picture of Contact and Assistance." They indicate that a significant minority of the elderly, many of whom need assistance with activities of daily living, have little or no contact with children, either because they have no living children or because there is little contact with children who are living. Contact between children and "vulnerable" elderly appears to be less than that between children and the nonvulnerable elderly, and the amount of contact between children and the institutionalized elderly appears the least of all. In addition, although many of the parents in the sample are poor, financial support from children to parents, other than in the form of shared housing, is uncommon. The initial impression conveyed by the data is that many of the elderly are well cared for by their children, while a significant minority either have no children or have no children who provide significant time or care.

Labor Force Participation and Retirement

In "Employee Retirement and a Firm's Pension Plan," Laurence Kotlikoff and David Wise are continuing their work on the incentive effects of private pension plans. They analyze the relationship between pension wealth accrual and retirement, based on the experience of a Fortune 500 firm. For completeness, salary earnings and the accrual of Social Security benefits are analyzed together with pension benefit accrual. The analysis makes it clear that departure rates from the firm are very strongly related to the incentive effects inherent in pension wealth accrual. Because of the strong incentive effects, especially the advantageous early retirement provisions, only about 10 percent of the employees in the firm at age 50 are still working in the firm at age 65; fewer than 50 percent are still working in the firm at age 60. Kotlikoff and Wise note that while a great deal of effort has been directed to estimating the effects of Social Security provisions on labor force participation, much less attention has been given to the effects of private pension plans. They postulate that their data suggest that pension plan provisions have had a much greater effect on retirement than the recent changes in Social Security benefits. They will continue their work with a more formal analysis of data from the same firm.

Douglas Bernheim is working on a series of studies on the relationship between expectations of the elderly about future income, age of retirement, and other variables and their actual realizations. In an earlier paper (Bernheim 1987), he analyzed evidence on individual predictions about future Social Security benefits versus benefits actually received. He showed that estimates of future benefits would be greatly improved if individuals had information on what benefits would be if they were to retire at the current age, say 60; advance calculations would add greatly to individual knowledge. In a companion paper in this volume, "The Timing of Retirement: A Comparison of Expectations and Realizations," he studies the accuracy of expectations concerning the timing of retirement. He finds that expectations about age of retirement are quite accurate. More than 60 percent of the elderly expecting to retire within four years actually retired within one year of the expected date. Both papers are based on data from the Retirement History Survey. An underlying theme of the work is to test explicitly assumptions that are commonly made when modeling retirement decisions and when considering other life-cycle behavior.

John Rust, in a very ambitious effort, has developed "A Dynamic Programming Model of Retirement Behavior." His model accounts for the possibility that retirement plans change over time, and for the role of expectations about uncertain future variables such as the worker's life span, health status, marital and family status, earnings from employment, assets, Social Security, and other variables. The primary work to date has been directed to the development of a computationally tractable algorithm to estimate such a model from observed data. The goal of Rust's work is to demonstrate that rather complex and realistic formulations of the retirement decision can be estimated using his algorithm. He hopes that his procedure will be useful for others in the analysis of similar problems.

Financial Status

About 80 percent of the elderly poor are single; 60 percent are widows. Two project papers are aimed at analyzing the reasons for the greater poverty of widows and for their less-favorable future prospects.

In "The Wealth and Poverty of Widows: Assets before and after the Husband's Death," Michael Hurd and David Wise, by tracing backward to the financial status of the couple before the death of the husband, attempt to explain how widows become poor. Their analysis is based on the Retirement History Survey. They find that, based on standard definitions of poverty, the death of a husband very often induces the poverty of a surviving widow. A large fraction of the wealth of the couple is lost when the husband dies; the loss is especially large when the surviving widow is already poor. If the widow had been poor, then almost all the private pension wealth of the prior couple was lost at the husband's death. In addition, the prior households of poor widows, on average, saved less than the households of nonpoor widows. The typical couple had very little life insurance before the husband's death and, therefore, no way to make up the loss in wealth when he died.

In a companion paper on "The Poverty of Widows: Future Prospects," Michael Hurd estimates the future economic status of widows. He begins by estimating the future financial status of the Retirement History Survey population as it ages. The analysis rests on a model of consumption as single persons age. He then considers changes in the initial conditions of the Retirement History Survey population, such as increased pension coverage and increased Social Security benefits, and the implications of such changes for the financial status of widows in the future. By the year 2000, up to 60 percent of the surviving cohort of 1979 widows will be below the poverty level, based on his consumption measure of poverty. His simulations show that increases in private pension coverage and survivorship rules will not do a great deal to reduce the poverty of widows. Only increases in Social Security benefits have a substantial effect on the proportion of widows in poverty. Increase in life expectancy also will have only a small effect on the poverty status of widows. The work highlights the need to understand why some families accumulate wealth while others do not. In general, poverty among widows will only be reduced if couples accumulate more wealth before the husband's death.

Health

Alan Garber has begun a series of studies on the economics of health care, focusing on long-term care and the worth of medical interventions for the elderly. His study on "Long-Term Care, Wealth, and Health of the Disabled Elderly Living in the Community" is an analysis of the relationship between financial status and the use of hospital, nursing home, and home health care by a sample of noninstitutionalized disabled elderly. It is based on data from the 1982 National Long-Term Care Survey. Among the findings of this initial work is that disabled elderly who live alone make much more use of paid home health care services than those who do not live alone. His preliminary results suggest that most of the disabled elderly who live in the community have significant resources and that home equity and income do not decrease with the number of functional impairments. The results confirm the view that the elderly who live alone use some long-term care services heavily, and that informal supports such as children appear to be an important source of care.

John Shoven, Jeffrey Sundberg, and John Bunker analyze "The Social Security Cost of Smoking." Among the costs of smoking in the United States is a reduction in the expected Social Security benefits resulting from a smoking-induced decrease in life expectancy. The paper estimates the magnitude of this loss for single and married men and women. The analysis rests on separate life tables for smokers and nonsmokers. They find that the expected loss of net benefits accompanying smoking to be very large relative to the estimates of medical costs and lost wages resulting from smoking. The results for single nonsmoking men show that they can expect to receive a net transfer from Social Security of $3,436, while the expected benefits received by smokers fall $17,782 short of their expected contributions. The Social Security costs of smoking for single men thus exceed $21,000 in expectation at age 20. Couples who both smoke have an expected net present value of participation in Social Security about $30,000 below that of nonsmoking couples.

Reference

Bernheim, Douglas. 1987. Social Security benefits: An empirical study of expectations and realizations. NBER Working Paper no. 2257. Cambridge, Mass.: National Bureau of Economic Research.