ECO 450G Notes
Fall 2006 Semester
University of Kentucky

Chapter 6 – Age and Health

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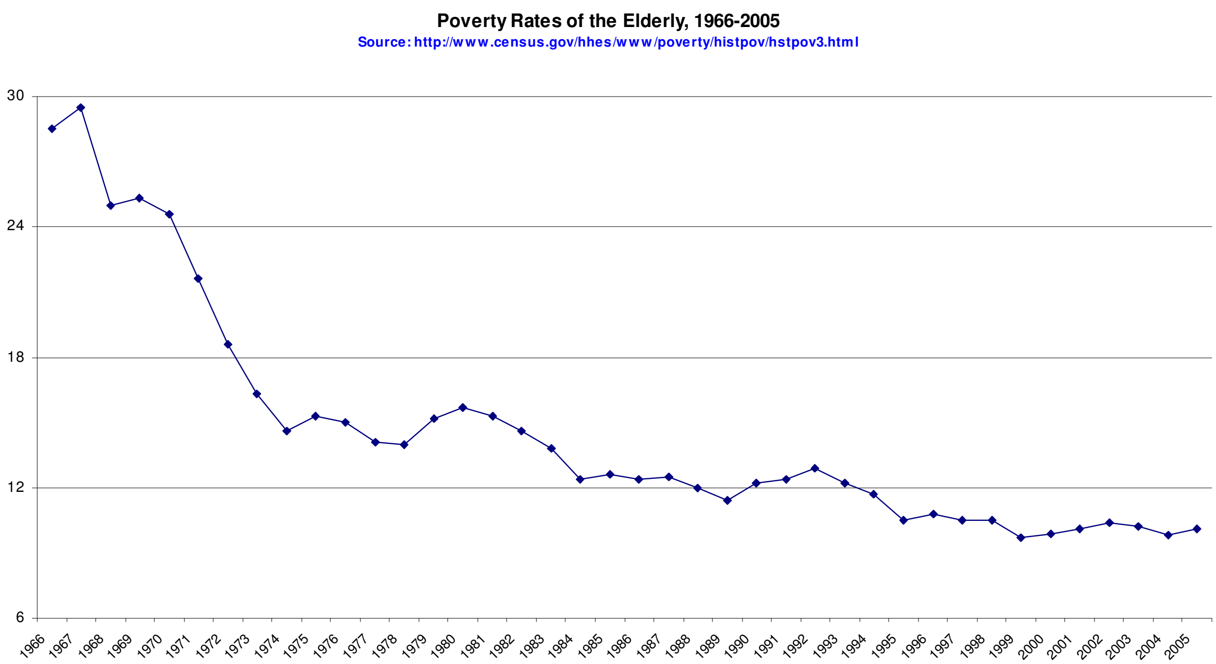
I. Age

Over 3.4 million elderly were poor in. Poverty counts exclude the institutionalized and perhaps some elderly living in "disguised poverty" with other, younger family members.

Declining Poverty Rate
The elderly have moved from being relatively disadvantaged to relatively advantaged. Poverty rates in the 1960s were higher than for other age groups, by the 1990s, poverty rates were among the lowest. Poverty rates were 10.1% in 2005 for the elderly.

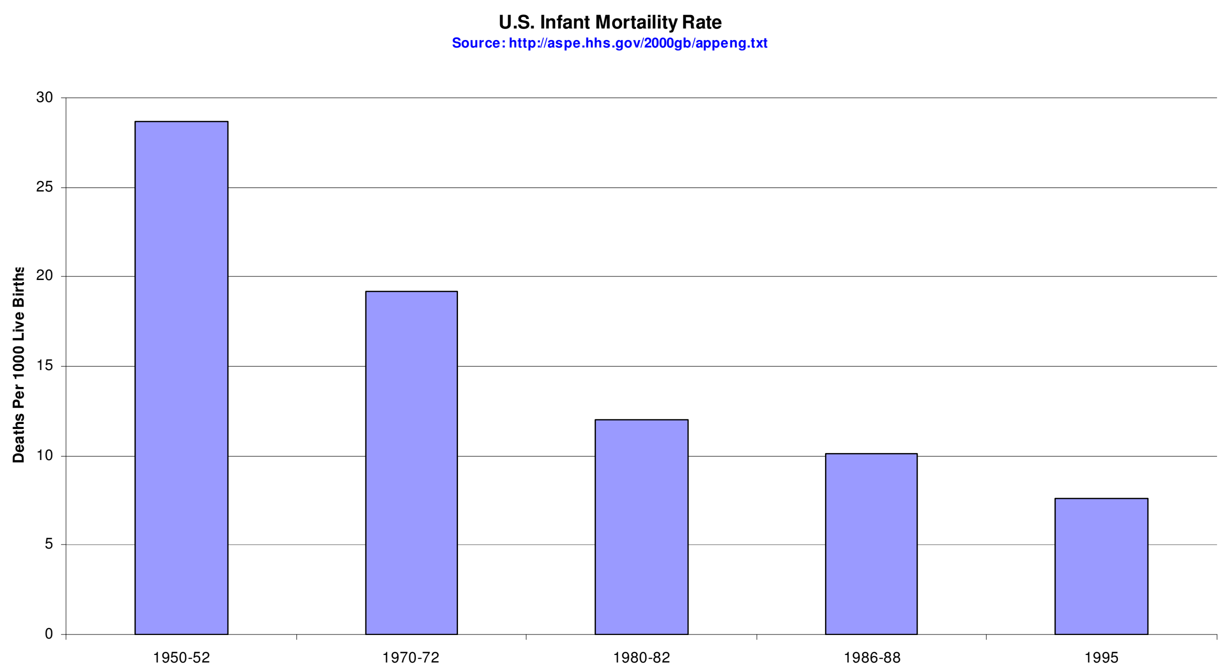


Why are poverty rates among the elderly low?

- Social Security is fairly generous, and indexed for wage inflation.
- Medicare and Medicaid are both valuable (although they do not count as income)

Life expectancy has increased dramatically. Life expectancy, conditional on reaching age 65, has increased from 11 years to 17 years in the past century.

The greatest gains in life expectancy have come from reductions in infant mortality at the beginning of life rather than from technologies at the end of life. Life expectancy at birth in 1900 was 49 years, now it is 76 years. Infant mortality, which is the number of infant deaths before age 1, divided by the number of infants born, has declined dramatically.



In 1940, 47 out of every 1000 live births resulted in death before 12 months of age; in 1998, only 7.2 out of every 1000. Most of those babies who would have died now add a lot of additional years to mortality.

Why should life expectancy matter for poverty rates?
Increased life expectancy leads to:

- Longer horizon where the elderly will need to finance their retirement. Holding income and savings constant, increasing the horizon will increase the likelihood of poverty. On the other hand, to the extent that individuals increase their retirement savings, poverty should be lower, especially for the younger elderly.
- Greater returns to investing in human capital.

Diversity Among the Aged
Poverty rates rise sharply with age – among those 85 and older, poverty rates are 50% higher than among those aged 65-74. (See Figure 6.2)

Why?

- *Family structure* often changes due to widowhood, and many husbands (who often die first) do a poor job of planning finances after their death.
- Elderly couples *draw down on their savings* during retirement – so younger couples have higher levels of interest, dividends and capital gains – all of which are income sources that reduce poverty.
- *Mortality induced selection bias*: The poverty gaps between the youngest old and the oldest old are actually understated, due to the link between health and wealth. Between 65 and 85, many individuals die – presumably those who are the least healthy. There are clearly documented correlations between income and health (where the poor are the least healthy), so if those who died before age 85 had instead reached that age, they would be poor than average. Hence poverty rates would be even higher.

Sources of Economic Support
There are several potential sources of income for the elderly:

- Earnings: Are not very important; labor force participation rates are less than 20%. There has been a dramatic trend downward over the century in labor force participation of the elderly, even though jobs are less physically demanding and the elderly are healthier.

  Declining labor force participation is likely related to
  a) the growth in wealth,
  b) the growth in the amount of income that Social Security replaces,
  c) the growth in disability income,
  d) the increased opportunities for leisure,
  e) reduced demand for skills of the elderly, and
  f) forced retirement.

  Schiller cites a 29-year old study that reports that many older persons were "forced" out of their jobs. It is not clear whether the numbers would be similar today, and it is not clear how long those people who were forced out of their jobs would have remained at their job anyhow. The earnings loss is likely not that large.

- Assets: Wealth levels are often inadequate for retirement, in the absence of social security. Schiller reports that the median household net worth was around $160,000, most of which is held in the form of home equity. Financial assets - stocks, bonds, bank accounts, 401(k)'s, etc. – are on average less than 20% of wealth holdings.

The numbers from the Census Bureau for 2000 show somewhat lower wealth levels than Schiller reports. See http://www.census.gov/prod/2003pubs/p70-88.pdf , Figure 5. Different data sources may come to different findings, however.

Although houses are less liquid than other assets such as stocks or mutual funds, there are ways to get cash out of your home besides selling it or refinancing it. The elderly can get a “reverse mortgage” – which is paid off when the person dies from the proceeds of the home. See http://www.aarp.org/revmort/ for details.

These wealth levels also do not include the value of defined benefit (DB) plans – pensions that are based on years of service, age at retirement and highest wages. They do include defined contribution (DC) plans like 401(k)s. The wealth levels also do not account for social security wealth – the fact that social security is an annuity that pays you until death. The levels also do not include anticipated bequests that may be received from even older parents.

● Income sources: The nonpoor have more income from assets and pensions; they also have substantially more earnings (and unemployment insurance), which suggests that they are also probably younger. The poor are more likely to have cash welfare, from Supplemental Security Income (SSI) as well as food stamps and housing.

New Poverty or Continuing Poverty?
Why didn’t the elderly adequately plan for their retirement?

● Squandered Income: Schiller asserts “There is no evidence that the aged poor enjoyed especially lascivious or spendthrift lives.” (page 113). Hence, Schiller is arguing that restricted opportunity is largely the result for poor elderly – e.g., “misery of their old age is simply the conclusion of a life of misery. ... Many, probably most, of the aged poor were always in or on the margin of poverty.”

On the other hand, the fact that “people’s essential optimism is revealed in consumer surveys such as one disclosing that families who have not had as much as $500 in the bank during the last five years confidently anticipating a comfortable retirement” is more of a statement about flawed character – that individuals are not always willing to take the difficult, necessary steps of foregoing consumption today for a better retirement.

Finally, the economics literature suggests that income- and asset-tested welfare programs deter people from saving for their retirement, because tax rates on wealth can be 100%. Thus, big brother may play a role in low savings and poverty.

● Pensions: Schiller assets that many “pension plans are often great disillusionments ... many workers ... find that they have no pension rights." This statement may have been relevant 30 years ago, but is not nearly as important now. The vesting period for pensions is now between five and seven years – see http://www.bls.gov/opub/mlr/1988/08/art4full.pdf for discussion.

It is true that most defined benefit pensions are not indexed for inflation, so their real value declines over time.

- Social Security Benefits: Are far-reaching, and the most important single income source for the elderly. They are adjusted for inflation, and vary based on contributions into the system during one's working life. Although benefits are higher for those with higher earnings, social security implicitly redistributes to low-earners because the benefits formula is progressive.

- Family Support: Less than one-third of the elderly live with relatives; not much support comes from offspring. Schiller asserts that many of these elderly are in "disguised poverty" because they do not command enough economic resources to really have a choice about whether to live on their own. The same argument could be made for many other family members, however – some married couples remain married more out of economic necessity than anything else.

- Welfare: SSI is a fairly important source of income support for the poor, and has more generous benefits than TANF. Over one-third of the poor elderly receive a welfare benefit.

Rising Health Costs

Only 1 out of 6 elderly self-report themselves in "excellent" health, and the fraction who experience limitations with ADLs (Activities of Daily Living) rises dramatically with age. Out-of-pocket health care costs average around $3000 per year for the elderly. Medicare, which covers virtually all elderly, pays for many health care costs but not all.

Until recently Medicare did not prescription drugs, and Medicare does not cover many nursing home costs. Medicaid covers some of these gaps for the poor elderly.

Tax Burdens

The elderly also pay property taxes that are related to the value of the home, which is usually rising. Many states have additional exemptions for the elderly, to insulate them to some extent from rising property taxes. Some states, like California, have explicit limitations on the assessed value of the house, which in turn disproportionately benefits long-term dwellers.

Schiller presents no evidence on the importance of property taxes for the well-being of the elderly.

Assessing Causation

Some of the poor elderly were always poor, others were not. There are potentially merits to many explanations for why people are poor.

II. Health

Good health contributes to economic security by lowering health care costs, increasing work productivity and increasing wages. Figure 6.5 shows that those who are disabled are much more likely to be poor. Schiller breaks out the sample into those with a "severe" disability and "any" disability, but the CPS questionnaire doesn't make that kind of classification.

- The CPS asks:

  "Does (the respondent) have a health problem or disability which limits the kind or amount or work?"

  "Did (the respondent) retire or leave a job for health reasons."

  Both of these do not simply ask about disabilities, but how those disabilities affect work. Hence, it is not surprising that there is a strong relationship.

Causality
Disabilities can make it difficult for a person to work, and thus, be poor. On the other hand, low income can result in a variety of health problems and disabilities. Poor families have higher disease and mortality rates at any given age, and more absenteeism.

- Schiller asserts on page 121, "A family need not be far above the poverty line to have an adequate margin against the against the burdens of ill health. ... Average medical expenses ... are around $3000 ... hence, for a typical family ... $22000 would easily prevent slippage into poverty as a result of illness."

  This statement is highly inaccurate. Medical expenses are *highly skewed*, meaning that many individuals have zero (or near-zero) expenses in a year, and others have tremendous expenses.

  The top 10 percent of health care users consume about 70 percent of services, while the bottom 70 percent only consume 10 percent of expenses. See Table 4 (page 125) of http://gatton.uky.edu/Faculty/yelowitz/450G/cutler.pdf . Thus, in the event of an adverse health outcome, it would certainly take more than the $3000 average to prevent slippage into poverty.

Health Insurance
Virtually all elderly have health insurance through Medicare, and many of the poor also have Medicaid. In the entire U.S. population, about 15% are uninsured for the entire year. The poor have less access private health insurance (in part because of lack of employment), but many do have access to Medicaid. Access to health care under

Medicaid is certainly better than under no insurance, but is usually worse than under a private plan; many doctors refuse Medicaid patients because the government reimbursement is too low. Emergency rooms are another option, but they too can turn people away and will try to collect on the bill.

III. Summary

Age and illness are both associated with poor economic status, but it is not clear which way the direction goes or why people got to the poor situation that they are in.