Choice, Chance, and Wealth Dispersion at Retirement

Why do some households have substantial wealth at retirement and others have very little? NBER Research Associates Steven Venti and David Wise look at data from the Health and Retirement Survey (HRS) and observe that no matter what the level of lifetime earnings, there is a large dispersion of accumulated wealth of families nearing retirement. Some families with low levels of lifetime earnings may accumulate substantial assets by retirement, while other families with high lifetime incomes may have very few financial assets.

In Choice, Chance, and Wealth Dispersion at Retirement (NBER Working Paper No. 7521), the authors find that life events outside the control of individuals, such as medical bills or inheritances, explain very little of this dispersion. Similarly, investment choices, from conservative to risky, have little effect on the wide dispersion of assets at retirement.

Instead, the bulk of the dispersion in wealth at retirement age is attributable to differences in the percentage of income that households choose to save. In other words, given similar lifetime earnings, differences in saving choices by families lead to major differences in levels of asset accumulation at retirement.

The authors also develop as a benchmark the assets that HRS respondents would have accumulated had they saved 10 percent of their earnings and earned the average of S&P 500 returns since 1926. This saving approach would have resulted in assets at retirement much greater than asset levels actually realized by HRS respondents.

The authors point out that their findings have implications for government tax policy, which currently penalizes people who save over their lifetimes. For example, among persons with the same lifetime earnings, savers with significant accumulated assets pay higher Social Security taxes than do those who have saved little and consumed more when younger. Such government policies seem to be based on the presumption that chance events have a much greater effect on accumulated wealth than is supported by the evidence. As a result, the authors suggest that such post-accumulation taxing of assets may have more serious consequences for saving than previously believed.

—Lester A. Picker

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Changing Patterns of Income and Happiness

Does money buy happiness? Philosophers, psychiatrists, social commentators, and journalists have long pondered the question. Now economists David Blanchflower and Andrew Oswald weigh in with their analysis in *Well-Being Over Time in Britain and the USA* (NBER Working Paper No. 7487). Their data source is the General Social Surveys of the United States from 1972 through 1992, a period of generally rising material living standards. The Survey shows that in the early 1970s, 34 percent of those interviewed described themselves as “very happy.” Yet by the late 1990s, the figure had shrunk to 30 percent. The trend seems clear: American society may be wealthier measured in dollars and cents, but we are less happy.

Yet Blanchflower and Oswald reject such a simple conclusion. Instead, a closer examination of the data suggests that some groups in society have become happier while others have suffered an evident decline in their sense of well-being. For example, the happiness of American men has grown over the past three decades. But the happiness of women, despite gains in the job market and legislation aimed at reducing gender discrimination, has diminished greatly. Blacks are less happy than whites. Yet the happiness gap between the races is narrowing. Black men and women show an upward slope in their happiness (with black men happier than black women) while whites are less happy than before. Higher income is also associated with higher happiness, although not by as much as many economists might suppose. The details of the American survey differ from the British figures, but the outline and equations are essentially the same. Taken altogether, after the typical statistical and analytical caveats, their answer to the age-old question is, “Yes. Money does buy happiness.”

The paper offers several intriguing calculations. For example, the biggest single depressant on reported happiness is the variable “separated from spouse,” followed by “widowed.” Being unemployed is similarly depressing. The authors calculate how much money it would take to compensate for a major emotional trauma. It would take about $100,000 extra per year to reimburse for the suffering of divorce or widowhood, and $60,000 a year to recompense men for the pain of unemployment. Put somewhat differently, a lasting marriage is worth $100,000 a year and a steady job $60,000 annually.

Blanchflower and Oswald’s results suggest that happiness is U-shaped over the life cycle. We seem to hit bottom somewhere around the age of 40. Perhaps that is good news for the United States at least. The mammoth baby boom generation is aging, and as a society we may feel better off in coming decades.

— Christopher Farrell

Liability Law Changes Raise Medical Productivity

Medical malpractice liability law has two principal objectives: compensating patients who are injured through the negligence of health care providers, and deterring providers from practicing negligently. Considerable evidence suggests that the current liability system in the United States achieves neither goal well — but is nonetheless extremely costly. In an era of changing markets for health care, what policy reforms might improve the ability of the system to meet its twin goals in a cost-effective way?

In two recent NBER Working Papers, Research Associates Daniel Kessler and Mark McClellan provide new evidence on the consequences of medical malpractice liability reforms for medical treatment decisions, health care costs, and patient health outcomes. They analyze how statutory reforms to liability law affect doctors’ and hospitals’ incentives to administer precautionary medical treatments, and in turn how these changes in incentives interact with the characteristics of health care
markets to affect the care of elderly Medicare beneficiaries with heart disease.

In How Liability Law Affects Medical Productivity (NBER Working Paper No. 7533), Kessler and McClellan show that malpractice reforms that directly reduce providers’ liability lead to reductions in the “malpractice pressures” facing physicians and hospitals – including both financial (for example, average compensation paid to litigated and settled malpractice claims) and nonfinancial (for example, the time spent and amount of conflict involved in defending against a claim) pressures. “Direct” reforms — such as caps on total or noneconomic damages — reduce the share of claims resolved with some compensation to plaintiffs, the share of claims with nonzero administrative and legal defense expenses, and the share of claims that take a long time to resolve. In turn, the authors show, these changes in incentives lead to reductions in medical expenditures, especially expenditures on diagnostic treatments, with negligible effects on mortality and rates of cardiac complications. This implies that direct reforms improve medical productivity by reducing defensive medical practices.

Kessler and McClellan note that these estimates can also be used to simulate the effects of untried reforms to the liability system, based on such reforms’ predicted effects on the malpractice pressure facing medical providers. For example, at least for elderly heart disease patients, an untried reform such as no-fault malpractice insurance that reduced the legal-defense burden on physicians and hospitals by one-quarter — which is within the range of policy possibilities — could be expected to reduce medical treatment intensity by approximately 6.2 percent, but not to increase the incidence of adverse health outcomes. In the same population, a policy that expedited claim resolution by six months across-the-board could be expected to reduce hospital treatment costs by 2.8 percent, without greater adverse outcomes.

In Medical Liability, Managed Care, and Defensive Medicine (NBER Working Paper No. 7537), Kessler and McClellan investigate the extent to which liability reform affects medical productivity differently in areas where health maintenance organizations (HMOs) are more versus less widespread. Because the optimal level of medical malpractice liability depends on the incentives provided by the health insurance system, the rise of managed care in the 1990s may affect the relationship between liability reform and productivity. For example, more parsimonious practices associated with managed care may have reduced physicians’ incentive and ability to engage in defensive treatment, thereby reducing the productivity-enhancing effects of liability reform.

The authors find that direct reforms improve medical productivity both in areas with low and with high levels of managed care enrollment. In addition, managed care and direct reforms do not have long-run interaction effects that are harmful to patient health. However, at least for patients with less severe cardiac illness, managed care and direct reforms are substitutes, so the improvement in productivity that can be achieved with direct reforms is smaller in areas with high managed care enrollment.

The authors observe that these results provide little evidence to support the expansion of liability to HMOs, on the grounds that the overall level of liability is insufficient. However, as Kessler and McClellan note, the consequences of a reallocation of liability from doctors and hospitals to HMOs, if the overall level of malpractice pressure were held constant, remain an open question.

Sentencing for Homicides in the U.S.

Why do murderers receive different sentence lengths for the same crime? In The Determinants of Punishment: Deterrence,

Incapacitation and Vengeance (NBER Working Paper No. 7676), Edward Glaeser and Bruce Sacerdote use Bureau of Justice Statistics data on murders to test the economic model of optimal punishment against alternative theories. The authors find much support for the optimal punishment view. For example, sentences are longest for crimes in which the apprehension rate is lowest, and
criminals with higher rates of recidivism are incarcerated for longer periods of time. Yet certain aspects of punishment are hard to reconcile with the optimal punishment view. Characteristics of the victims including gender, race, and occupation seem to matter in a way that suggests that vengeance plays a role in determining sentences. The most striking fact is that even in vehicular homicides where the choice of victim is fairly random, offenders killing blacks receive sentences lengths that are 53 percent lower than the sentences received by offenders who kill whites. Offenders killing men receive sentences that are 56 percent lower than sentences received by offenders who kill women.

No matter what type of murder is committed, as the probability of apprehending the criminal rises, the length of the sentence falls. Glaeser and Sacerdote conclude that lovers’ quarrels, arguments, and brawls involving alcohol have the highest chance of apprehension, and consequently the lowest sentence lengths. The crime of arson, which has an exceptionally low probability of apprehension, has the highest average sentence length. But “long prison sentences for arsonists may have more to do with the great potential for social damage created by arson,” the researchers concede.

The authors point out that if victims are chosen randomly, victim characteristics would not affect the criminal’s sentence length under an optimal system of punishment. To test this theory, they examine vehicular homicide data from the state of Alabama and the Bureau of Justice Statistics. Vehicular homicides typically involve substance abuse and reckless driving, and the victims are fairly random. Still, Glaeser and Sacerdote find that the drivers’ sentences depend heavily on victim characteristics. According to their data, victims’ race, age, and criminal record all determine sentence length, even in vehicular homicides. Drivers who kill black victims get substantially shorter sentences, but drivers who kill women receive significantly longer sentences.

How do the authors explain these findings? They propose that sentence lengths are driven, in part, by a taste for vengeance. They argue, “there is likely to be a much stronger visceral response to a drunk driver who accidentally kills an eight-year-old girl than to a drunk driver who accidentally kills a 22-year-old gang member.”

— Marie A. Bussing-Burks

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