Medicare Spending for the Very Old Outpaces All Other

For the past twenty years, the number of Medicare beneficiaries has increased by 50 percent and Medicare spending per beneficiary has doubled. This growth has occurred despite the fact that the health of Medicare beneficiaries has improved. In The Concentration of Medical Spending: An Update (NBER Working Paper No. 7279), NBER Research Associate David Cutler and Ellen Meara document how trends in spending, stratified by age, have changed among elderly Medicare beneficiaries. They also attempt to explain why health spending on the elderly has increased even though their disability rates have declined.

The authors find a trend of disproportionate spending growth among the elderly between 1985 and 1995. Spending among the younger elderly, those aged 65–69, rose by 2 percent per enrollee annually. In contrast, spending for those age 85 and above rose by 4 percent per enrollee.

According to the authors, the reasons for the large increase in spending on the oldest elderly relative to the younger elderly is the rapid increase in the use of post-acute services such as home health care and skilled nursing care. Spending on post-acute care for those over age 85 has risen 20 percent per year in the last decade, from $241 per Medicare enrollee in 1985 to $1,887 in 1995 (all figures are in 1995 dollars). Post acute services for the younger elderly grew by 15 percent per year during the same period, from $49 to $227.

“Spending on post-acute care for those over age 85 has risen 20 percent per year in the last decade, from $241 per Medicare enrollee in 1985 to $1,887 in 1995.”

Throughout the time period, disability rates among the elderly have fallen by about 1.5 percent per year. Since the disabled spend more on medical care than the non-disabled, spending on the elderly should be falling over time, at least in relative terms. The authors find that the increase in post-acute services explains the discrepancy between falling disability rates and increased spending on the elderly.

During the same time period, spending growth on acute services did not vary by age groupings within the elderly population. This is in contrast to earlier studies which showed that prior to 1987, the increased spending on the oldest elderly was primarily attributable to increased use of acute services.

The authors suggest that the increased use of post-acute services may be caused by a combination of three factors: first, a true increase in services for populations who were not receiving care in the past; sec-

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Asian Crisis Hurt Banks Less Than Was Thought

When in 1997 economies across Asia were suddenly knocked flying from their pedestals as the prima donnas of international development, many a learned analysis was quick to finger the banking system as the locus of the problem. Most notably, several critics argued that banks suffered steep losses—and thus contributed significantly to the crisis—because they had invested in a way that brazenly ignored the possibility of a sharp currency depreciation. This has lead some to call for requiring banks to do their borrowing and lending in the same currency.

But according to a recent examination of the situation, it may be that banks did not play an outstanding role in the crisis after all. And while in many Asian countries bank investors suffered mightily—during the crisis a dollar sunk into the Korean bank index dwindled to about 14.7 cents—for the most part, losses appear to be linked to the general economic slump, not to a bank-specific impact of the exchange rate drop.

In Banks, the IMF and the Asian Crisis (NBER Working Paper No. 7361), Bong-Chan Kho and René Stulz assert that an examination of bank performance during the period indicates that "currency returns do not seem to contribute to the poor performance of East Asian banks except for Indonesia and the Philippines" and that, aside from the exceptions noted, devaluations did not hurt banks "beyond their overall impact on the economy." In other words, they find "nothing unique about the exposure of banks to exchange rates."

"From our analysis, there is no support for the view that currency movements were consistently important determinants of the performance of banks in the crisis countries once one takes into account the stock market returns in these countries," the authors conclude. "Given the many statements made about the importance of currency exposures for the East Asian banks, our results are surprising."

Kho and Stulz reach their conclusion by comparing the performance of bank shares to broader market indexes for individual countries from January 15, 1997 to July 15, 1998, a period, they noted, that "includes all the important events of the Asian crisis." They assume that such market data "captures the common effects of exchange rate shocks across industries." Still, they consider that this notion might be flawed or "biased," that instead of having a broad impact the currency drop actually slammed banks so hard that their peculiar misfortunes skewed the overall market index, just as one bad stock can drag down an otherwise sound portfolio.

However, they feel confident that this was not the case. For example, in Thailand, where bank performance plays a large role in calculating the country's market index, one would have expected to see the now infamous collapse of the baht, and its subsequent deleterious affect on the national economy, to produce a particularly bad set of numbers for Thai banks. Instead, the opposite is true. Kho and Stulz discover that "in the case of Thailand, we find that banks benefitted from depreciation of the local currency so that the bias discussed here (the influence of bank performance on the market index) would make our results even more surprising." In other words, in Thailand, bank performance during the crisis made the index look better, not worse.

Also rejected by Kho and Stulz is the general notion that a wave of crisis-induced currency devaluations in Asia hurt U.S. banks. They note that even during a particularly turbulent five day period, Chase Manhattan earned a 5.09 percent return in excess of the return predicted by general stock market movement and that a dollar invested in a U.S. bank index at the start of the crisis would have been worth $1.73 at the end.

Finally, Kho and Stulz look at the crisis-induced bailout orchestrated by the International Monetary Fund (IMF) and dismiss an oft-stated justification for such rescues: that they benefit banks in general, not just those with extensive investments in the affected countries. The authors note that their data indicate IMF actions simply made it more likely that banks that loaned a lot of money in Asia would be repaid. They found no evidence that the bailout produced widespread benefits "by somehow reducing systemic risk."

The authors believe that the direct affect, or lack thereof, of the Asia currency crisis on banks could prompt further study to learn more about why the conventional wisdom seems to have missed the mark. For example, they note that banks might have "hedged" their bets more astutely than many observers think. They also wonder whether "the market expected the currency losses to be offset by bailouts."

—Matthew Davis

Social Security Reform Can Make Things Worse

Social Security gives people born in the second half of the 20th century a bad deal, according to Jagadeesh Gokhale and Laurence Kotlikoff, and the $8 trillion funding shortfall facing the system in the 21st century means that things are going to get worse. In Social Security’s Treatment of Postwar Americans: How Bad Can It Get? (NBER Working Paper No. 7362) the two economists show that choosing to keep Social Security in the black while maintaining the current pay-as-you-go approach has important consequences for which postwar
generations, and individual members of every age group, will pay.

Gokhale and Kotlikoff find that a straight cut in benefits distributes the burden more equally across generations than a straight tax increase. The other policy proposals—all variations on tax hike and benefit reduction themes—come somewhere in between the two benchmark cases in terms of intergenerational burden-sharing. One clear result of this research is that the youngest postwar generations have the most to worry about. Tax increases will affect them over their entire working lifetime. Graduated benefit cuts will be fully phased-in by the time they retire.

According to the Social Security Trustees, an immediate and permanent 38 percent increase in the Old Age Survivor Insurance (OASI) payroll tax rate would restore present value financial balance to the system. So would an immediate and permanent 25 percent reduction in all OASI benefits. These are the two benchmarks that Gokhale and Kotlikoff use, although they stress that the Trustees have tended to underestimate future funding shortfalls.

Because the Social Security benefits an individual receives depend on longevity, lifetime earnings, marital arrangements, and fertility, working out precisely how bad a deal postwar Americans receive requires an actuarial approach. The necessary data, following individuals from their first encounters with payroll taxes through to the end of their lives, has to be simulated. Gokhale and Kotlikoff do this by using a model developed by Cornell sociologist Steve Caldwell to generate a sample of 68,688 individuals which they divide into 11 five-year birth cohorts starting with 1945, and into lifetime earning quintiles. The model's starting point is a representative sample from the 1960 U.S. census, extended for demographic and economic changes each year through 2100.

As currently legislated, the authors write, postwar Americans lose 5 cents out of every dollar they have earned or will earn over their lifetimes in the form of payroll taxes paid into OASI in excess of benefits received. This can also be described in terms of an internal rate of return on contributions of 1.86 percent, which is less than half the rate now paid on inflation-indexed long-term government bonds.

An immediate payroll tax hike, by 38 percent, would be paid not just by Americans born between 1945 and 1999 but also by those born this year and in future years. However, the postwar cohorts would bear almost half the burden of filling the long-term budget gap of $8.1 trillion in present value terms. This is also the case with an immediate 25 percent benefit cut.

Both policies would raise the lifetime net tax rate for all postwar generations. But they have very different intergenerational impacts. The tax hike has a much greater impact on later generations, with more years left to work and also pay the tax, than earlier generations. In the case of the benefit cut, all generations are similarly affected because none has yet started to receive benefits. The tax hike raises the net lifetime tax rate for the generation born in the five years from 1945 through 1949 from 5.3 to 5.7 percent. It raises the lifetime net tax rate for the generation born in the six years between 1995 and 2000 from 5.4 percent to 8.4 percent. In contrast, cutting benefits leaves both cohort's lifetime tax rates at 6.0 and 6.1 percent respectively.

Eliminating the earnings ceiling, with or without a change in the ceiling on benefits, hurts younger generations much more than older ones. This also goes for linking benefits to inflation (cutting out the link with wages) and eliminating the real growth in benefits. Accelerating the already legislated increase in the normal retirement age would hurt older cohorts—those close to retirement—more than younger cohorts.

Both the benchmark tax increase and the benefit cut are harder on the

“Postwar Americans lose 5 cents out of every dollar they have earned or will earn over their lifetimes in the form of payroll taxes paid into OASI in excess of benefits received.”

Incentives Increase Work by Single Mothers

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When government policies make it pay for poor, single mothers to go to work, more of them do so. Between 1984 and 1996, policies governing welfare, Medicaid, and taxes were changed dramatically to increase the financial incentives for single mothers to get jobs. The changes worked. Single mothers, particularly those with young children, joined the work force in unprecedented numbers in that time period, according to Bruce Meyer and Dan Rosenbaum writing in Welfare, the Earned Income Tax Credit, and the Labor Supply of Single Mothers (NBER Working Paper No. 7363).

Much media attention has focused on cuts and time limits in welfare and on the implementation of workfare programs since passage by Congress of the Personal Responsibility and Work Opportunity Reconciliation Act of 1996. But many
policy changes prior to that act increased the financial rewards of working, rather than just cutting welfare benefits, authors Meyer and Rosenbaum note. These policy changes included large expansions of the earned income tax credit (EITC), a program that gives federal money to those working but earning little. For instance, in 1984, the average single woman with children who earned $10,000 that year paid about $100 in income and payroll taxes. By 1996, that average single mother received a $2,000 subsidy for working, mostly due to the EITC.

Increases since 1993 in the tax credit rate and maximum credit were particularly large. Also Medicaid, which pays for medical care for those families with low incomes, was expanded for families with working mothers. Between 1984 and 1994, the number of children receiving Medicaid increased 77 percent, while the number of covered adults with dependent children increased 35 percent. These expansions primarily helped non-welfare families with incomes near the official poverty line, making work more attractive for low-income single mothers.

Another change that took place during this period was the reduction in the implicit tax rate for welfare mothers. In other words, they lost somewhat less of their benefits when they earned other income. Welfare benefits were cut for those not working, but benefits changed little or increased for those balancing work and welfare. Between 1984 and 1996, the real value of AFDC (welfare) and Food Stamps for a woman who did not work fell on average by 7 percent. The amount of benefits received by a working women earning $10,000 rose slightly on average. Further, four new child care programs were added between 1988 and 1990 to look after the children of welfare mothers going to work and other low income women. Expenditures on job training programs increased sharply in the early 1990s. The programs emphasized education and basic skills. As a result of all of these changes, between 1984 and 1996 the percentage of single mothers working in an average week increased from 58 percent to 64 percent. Or, looking at another measure, the percentage working at all during the year rose from 72 percent to 82 percent. Comparisons with other groups, such as single women without children, married women, and black men, indicate that the increase in single mothers' employment is "a break from historical patterns," the authors write.

Using data from all 50 states and the District of Columbia, Meyer and Rosenbaum estimate that the increases in the EITC account for about 63 percent of the increase in weekly employment of single mothers between 1984 and 1996 and also 63 percent of the annual employment increase. Changes in the maximum welfare benefit and implicit tax rates account for about 26 percent of the increase in weekly employment, and about 14 percent of the change in annual employment. Welfare waivers (time limits, tougher work requirements, termination of cases under certain rules) account for about 15 percent for both weekly and annual employment increases.

Changes in Medicaid, training programs, and child care expansions play a smaller role. But for the amount spent on training and child care, their impact is substantial. Medicaid changes have had little effect.

—David R. Francis

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