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4.1 Introduction

The sustainability of, and trade-offs involved in, government expenditures for the elderly has become increasingly topical in recent years. An adequate examination of policy options has to be based on a sound assessment of the economic well-being of the elderly. The most widely used measure of economic well-being in considering the gaps between elderly and nonelderly households is money income. However, as several studies have pointed out, money income does not reflect elements that are crucial for the economic well-being of the elderly such as noncash transfers (which are completely excluded from money income) and wealth (for example, Radner, 1996; Rendall and Speare, 1993).

For instance, the economic advantage from wealth ownership reckoned in the money income measure is limited to actual property income (dividends, rent, and interest). However, a more comprehensive measure would take into account the advantage of home ownership (either in the form of imputed rental cost or annuity on home equity), and the long-run benefits from the ownership of nonhome wealth (for example, in the form of an imputed annuity) makes up the large share of economic well-being, especially, of the elderly. Government expenditure and taxes are another example. They are known to have an equalizing effect on the economic well-being between the elderly and nonelderly. The extent of the gap between the two groups, however, is sensitive to the types of expenditures and taxes that are taken into account as well as the income concept used to reckon economic well-being.

The recently developed Levy Institute Measure of Economic Well-being (LIMEW) and its associated microdatasets offer a comprehensive view of the...
level and distribution of economic well-being in the United States during the period 1989–2001. By means of such a comprehensive measure, it allows policymakers to gain better insights into the relative importance of different resources in sustaining or improving the economic well-being of the elderly and forces shaping inequality among the elderly.

We first describe the methodology and data sources for the LIMEW (Section 4.2). Next, we turn to estimates of the measure for both nonelderly and elderly households and for some key demographic subgroups among the elderly household population. The relative importance of different sources of income in sustaining the well-being of the elderly will be discussed. In Section 4.4, we discuss economic inequality among the elderly and the nonelderly. We also compare our findings based on the LIMEW with those based on the official measures in Sections 4.3 and 4.4. The final section contains our concluding observations.

4.2 Components of the LIMEW

The LIMEW is constructed as the sum of the following components (Table 4.1): base income; income from wealth; net government expenditures (government expenditures minus taxes); and household production. Our basic data is drawn from the public-use files from the Census Bureau. The calculation of base income (see below) uses values reported in the Census files for the relevant variables, without any adjustment. Additional information from Federal Reserve surveys on household wealth and surveys on time-use are incorporated into the Census files via statistical matching to estimate income from wealth and value of household production. Information from a variety of other sources, including the National Income and Product Accounts (NIPA) and several government agencies is utilized to arrive at the final set of estimates.

We begin with money income and subtract the sum of property-type income and government cash transfers. We then add employer contributions to health insurance to obtain base income. Labor income (earnings plus value of employer-provided health insurance) makes up the overwhelming portion of base income and the remainder consists of pensions and other small items (for example, interpersonal transfers).

Our next step is to add imputed income from wealth. The actual, annual property income as in money income by Census Bureau is a very limited measure of the economic well-being derived from the ownership of assets. Houses last for several years and yield services to their owners, thereby freeing up resources otherwise spent on housing. Financial assets such as bank balances, stocks and bonds, can be, under normal conditions, sources of economic security in addition to property-type income.

Our approach to the valuation of income from wealth is different from the methods suggested in the literature (for example, Weisbrod and Hansen