NOTES AND COMMENTS

THE IMPORTANCE OF ASSET INCOME AMONG THE ELDERLY*

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This paper focuses on the income patterns among the elderly. The life cycle hypothesis suggests that income and assets will decline after retirement. Data from the 1980 U.S. decennial census confirms that total income declines for succeeding elderly cohorts. The census data, however, shows that income from assets for elderly cohorts increases until the cohort aged 85 years and older. This pattern is similar for different sex-marital groups. Recent research that has addressed the issue of savings among the elderly is summarized and four possible explanations for the increase in income from assets found in the decennial census are discussed. We conclude by suggesting the implications of this data for the life cycle theory and public policy.

The generalized life cycle hypothesis predicts that "net worth should tend to rise with age up to the prevailing age of retirement and fall thereafter." Moreover, "the saving of the younger generations would be keyed to providing for a rate of retired dissaving exceeding correspondingly the rate of dissaving of the generations currently retired" (e.g. Modigliani, 1980). While the hypothesis is intuitively appealing, a number of studies suggest that saving is complicated by such factors as uncertain life expectancies, life style, bequest motives, and illiquid assets. Data from the U.S. 1980 decennial census raises questions about the prediction of the life cycle hypothesis that the assets of the elderly decline after retirement.

Some studies have found that the elderly do dissave. A cross-sectional study of 13,000 families, which controlled for permanent income of each cohort, found that the elderly did dissave as they grew older, but not by as much as the life cycle hypothesis predicts (e.g. King and Dicks-Mireaux, 1972). A longitudinal study of people who are newly aged also found that the real wealth of the respondents declined as they grew older, but only after the sixth year of retirement (e.g. Friedman, 1982). A third study suggested that uncertain life expectancies might explain why the dissaving in these two studies may be less than the life cycle hypothesis implies (e.g. Davies, 1981).

Other studies, however, have suggested that there may be no dissaving at all. Kotlikoff (1979) found no evidence that the availability of social security reduced aggregate saving; he did find reduced saving among the young and speculated that this was offset by increased saving among the old. Mirer's (1979)

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cross-sectional study of elderly couples showed that wealth increased with age after he corrected his data for differences among cohorts in wealth at retirement. And Menchik and David's results (1983) "fail to show individuals decumulating wealth in old age." The information from the 1980 census supports the possibility that the elderly may not, in general, reduce their savings significantly at least until they become very old.

Data from the 1980 U.S. Decennial Census

The decennial census is a unique source for age-specific data on income among the elderly. Most cross-sectional surveys do not have sample sizes for the very old that are statistically reliable, and longitudinal surveys have not yet followed a significant number of the retired into very old age. The decennial census, however, contains extensive data on elderly cohorts for one point in time. Cohort analysis from cross-sectional data must be done cautiously because each new cohort of the elderly has a different economic history than its predecessors. And new cohorts' economic behaviour may differ from previous cohorts because of the differences in their economic histories. Because the data in the 1980 decennial census on sources of income does not describe economic behavior over time, it can only give clues rather than definitive evidence about the economic behavior of elderly cohorts as they age. But since the decennial census is the only reliable source of data for the economic status of the very old, what clues it offers are valuable.

According to the 1980 census, average total income for the elderly who received income declined steadily with age, as shown in Table 1. The proportion of each cohort that received income dropped moderately with age; the average income for those 85 years and over was 39 percent lower than for the cohort 65 to 69 years of age. Earned income made most of the difference, with labor force participation dropping 74 percent between the two cohorts. The drop in income between the two cohorts, however, is cushioned by an increase in average income from assets (net rent, royalties, interest, and dividends) for the 41 percent of the elderly who received asset income in 1979. The average income from assets increased between the ages of 65 and 74 years (from $3,900 to $4,200) and then stayed essentially constant for those 75 years of age and over ($4,300).

It is important to note that, in general, average income is higher than median income for most groups, including the elderly. This is because of the inequality of the income distribution. Therefore, while income averages are useful for indicating trends and relationships among groups, they are less useful than medians in measuring the adequacy of income for a specific group.

The importance of the relationship of cohort age and asset income described in Table 1 is actually greater than stated because of the cohort effect; that is, the very old have lower lifetime earnings, on average, than the newly aged, as shown in the social security wage histories of each cohort, Therefore, the very old had less economic resources from which to accumulate assets. For this reason, other things being equal, one would expect average asset income to decline with the age of the cohort.

TABLE 1

AVERAGE INCOME OF THE ELDERLY BY AGE AND SOURCE FOR THOSE WHO RECEIVE THAT TYPE OF INCOME: 1980

	Total	65–69	70–74	75–79	80–84	85+
Total Income (in dollars)	$7,505	8,621	7,543	6,923	6,381	5,540
Earnings	7,745	8,616	6,832	6,520	6,566	6,806
Social Security	3,237	3,211	3,333	3,320	3,203	2,857
Other non-property sources (private pensions, public assistance, etc)	3,680	4,164	3,778	3,346	3,044	2,824
Interest, dividends, royalities, or net rental income	4,117	3,860	4,151	4,342	4,327	4,320
Percentage of Each Cohort That Receives Income						
Total Income	94	95	95	93	92	89
Earnings	20	31	20	13	9	8
Social Security	80	78	84	83	80	75
Other non-property sources	34	34	35	34	35	33
Interest, dividends, royalties, or net rental income	41	41	42	41	40	34
Average Income Multiplied by the Percentage of Each Cohort That Receives Income						
Total Income (in dollars)	$7,055	8,177	7,163	6,519	5,947	4,950
Earnings	1,544	2,671	1,298	848	591	408
Social Security	2,589	2,505	2,797	2,956	2,562	2,143
Other non-property sources	1,251	1,416	1,322	1,138	1,065	932
Interest, dividends, royalties, or net rental income	1,687	1,583	1,743	1,780	1,731	1,469

Source: Bureau of the Census, 1980 Decennial Census, unpublished tabulation from the 5-Percent Public Use Microdata Sample.

The decline in overall income and the increase in asset income occur, not only for the elderly as a whole, but also when classified according to sex and marital status (Table 2). To the extent that people do not change their status as they age, the sex-marital categories reflect groups with different household sizes, tastes, and lifetime earnings patterns. Of course, what happens to economic status when marital status changes cannot be determined from cross-sectional data.

The average total income of couples declines a little faster than for unmarried men and women, but all three groups show a decline in total income. The average income from assets increases a little faster for couples than for unmarried men and women. The proportion of the elderly in each of these categories that received income from assets stays remarkably constant from age 65 years to 84 years. Only the cohort age 85 years and over shows a drop in the proportion of people in all groups receiving income from assets, and the drop is small.

If the average income from assets is multiplied by the percentage of elderly receiving asset income, then the combined trends produce a 10-percent increase in asset income between aged groups 65 to 69 years and 70 to 74 years, which then remains essentially constant for 10 years. The only drop in asset income occurs at age 85 years and over.

TABLE 2

INCOME OF THE ELDERLY BY AGE, MARITAL STATUS AND SEX: 1980

Groups of elderly	65-69 years	70-74 years	75-79 years	80-84 years	85 years and over
Average total income (in dollars) for those who receive income:					
All elderly	$8,621	7,534	6,923	6,381	5,540
Married couples	17,458	15,018	13,676	12,810	11,723
Unmarried men[1]	8,641	7,605	7,183	6,865	6,338
Unmarried women[1]	7,023	6,462	5,996	5,536	4,803
Average income (in dollars) from assets of those who receive asset income:					
All elderly	$3,860	4,151	4,342	4,327	4,320
Married couples	5,046	5,663	6,261	6,546	6,389
Unmarried men[1]	3,764	4,173	4,412	4,349	4,723
Unmarried women[1]	3,501	3,761	3,894	3,889	3,967
Percentage of cohort receiving income from assets[2]:					
All elderly	41	42	41	40	34
Married couples	60	60	59	58	55
Unmarried men[1]	35	35	35	37	35
Unmarried women[1]	42	42	41	39	33
Average income (in dollars) from assets[2] multiplied by the percentage receiving asset income.					
All elderly	1,583	1,743	1,780	1,731	1,469
Married couples	3,028	3,398	3,694	3,797	3,514
Unmarried men[1]	1,317	1,461	1,544	1,609	1,653
Unmarried women[1]	1,470	1,580	1,597	1,517	1,309

[1]Includes persons who are divorced, widowed, and those who have never married, as well as those who are married but separated.

[2]The 1980 census includes only income from interest, dividends, royalties, and net rental income. It specifically excludes lump-sum payments such as money from an inheritance or the sale of a home, but includes the interest derived from the payment.

Source: U.S. Bureau of the Census, 1980 Decennial Census. Unpublished tabulations from the 5-Percent Public Use Microdata Sample.

For all age groups, income data from the census are generally biased downwards, and income from property is underestimated more than income from wages and salaries and social security. It is probable, however, that the data on people 65 years and over suffer from a greater measure of error and are affected by biases to a greater extent than data for the younger population because people 65 years of age and over tend to underreport their money income considerably more than the non-elderly (e.g. Rander, 1981). If the trend of underreporting continues to increase with age after age 65 years, then the resulting trends in this paper and their implications for the life cycle theory are underestimated.

The underreporting of income is the result of both underestimating the amount of income received and underreporting whether the income is received

at all. For example, the number of elderly who say they received social security income is almost 2 million less than social security records show. Also, 67 percent of the respondents in the retirement history survey had income from assets compared with the 41 percent reporting in the 1980 census (e.g. Friedman and Sjogren, 1980). Further, the elderly tend to have a higher nonresponse rate to income questions than the general population. These comments are a warning not to make too much of small differences since they may be a result of data error. In general, however, the data show a reasonable picture in terms of consistency of patterns, and there is no evidence that the trends in income from other sources are biased.

Possible Explanations for the Increased Income from Assets of the Elderly

There are several possible explanations for the increase in income from assets despite the prediction of the life-cycle hypothesis: the conversion of illiquid assets such as a house to income producing assets; the greater longevity of the rich than the poor; the inheritance of wealth from family and friends; and a decrease in consumption allowing continued saving by the elderly. The first three explanations would be consistent with the life cycle hypothesis if they were correct, but the final explanation would contradict it.

The life cycle hypothesis predicts that the elderly in general will convert their illiquid assets, such as their home, into liquid assets to produce income and to make dissaving easier. Home equity is almost two-thirds of the median net worth of the elderly (e.g. Friedman and Sjogren, 1981), and approximately 3 percent of the elderly sell their homes each year. In the 1979 American Housing Survey, only one-third of those who sold homes rented the following year, and, therefore, could have realized a substantial increase in their liquid, income-producing assets. Two-thirds of the elderly home sellers bought another home: a remarkable 72 per cent bought homes of equal (23 percent) or greater (49 percent) cost than the home they sold (e.g. Torrey and McGough, 1982). Therefore, almost half of the elderly who sold their homes bought another house of similar or higher value and just over half (52 percent) rented or bought down. A longitudinal study of elderly households from 1969 to 1977 found that their home equity increased over the 8-year period. For the elderly who moved, "trading up outweighted trading down: there was a greater propensity to switch from renting to owning than the reverse" (e.g. Merrill, 1984). Therefore, both cross-sectional and longitudinal surveys suggest that the elderly, in general, do not convert their illiquid equity in their home into a liquid asset, and therefore, this cannot explain the increase in income from assets among elderly cohorts found in the 1980 decennial census.

A positive relationship between economic status and longevity would make a cohort appear wealthier as it ages even if each person's assets remain constant. However, Mirer (1979) concluded that differences in mortality rates did not appear to be important in explaining an increase in wealth with age. And when Sharrocks (1975) corrected for differential life expectancies in his study, he found that wealth actually decreased with age. Therefore, it seems unlikely that a direct

relationship between economic status and longevity will explain why asset income of the elderly does not decrease with age.

However, inheritances from spouses, relatives, and friends could substantially increase the assets of the diminishing number of survivors in each aged cohort and explain the increase in income from assets found in the decennial census. There is, however, not enough research to confirm this transfer of wealth. Smith, Franklin, and Orcutt (1977), using the Washington, D.C., 1967 Inheritance Tax File, found that the probability of making a bequest outside the immediate family was 19 percent for decedents who are married and 60 percent for decedents who were divorced, separated, or widowed. When wealth is bequeathed outside the family, more than four-fifths of the estate is passed on to someone other than charities or government. If the recipients of the bequests are in the same cohort as the decedent, then the average assets within the cohort would grow as the cohort diminishes in size. But until this transfer of wealth can be documented, it remains only a speculation.

There is, however, increasing evidence that the consumption of the elderly declines with age. Studies of the 1972 Consumer Expenditure Survey (e.g. Danziger, *et al.*, 1982) and the longitudinal Retirement History Survey (e.g. Hammermesh, 1981) found that the average propensity of the elederly to consume declines with age. If the observed reduction in consumption results in continued saving, then income-producing assets of the elderly would increase as described by the 1980 census. The possibility that the elderly are continuing to save until they reach 85 years of age, however, is inconsistent with the prediction of the life cycle hypothesis; it is also contrary to the expectations of policymakers.

Implications for the Life Cycle and Public Policy

The positive relationship between the age of the elderly and their income from assets found in the 1980 census is a suggestive clue rather than definitive evidence that the elderly may continue to save as they age. This observation is limited by the nature of the cross-sectional data. But, if this suggestion is confirmed by longitudinal studies of aging cohorts, then the life cycle hypothesis would have to be modified to account for it. The hypothesis may have correctly suggested that the maintenance of consumption over a lifetime is a major motive in determining economic behavior. But if economic independence and security are also major goals, then as income declines, savings may increase to maintain economic security. While there is an indisputable life cycle for income, an almost level "life line" might be a more accurate description of asset accumulation for the elderly.

The income and wealth of the elderly is particularly important in formulating public policies for the elderly. The Federal support of the elderly is expected to continue increasing as a share of the U.S. Federal budget for the next 60 years (e.g. Torrey, 1982). The problem of support of the elderly will become most acute in less than 30 years, when the baby boom begins to reach its 65th birthday and becomes the grandma boom. In 1985 there were five persons of working age for every elderly person, but by 2025, there will be only three workers per elderly person (e.g. Taeuber, 1982). How the fiscal burden for the support of the elderly

should be shared depends in part on what resources are available. If the elderly, in general, enjoy the same economic status as the non-elderly, as suggested by a number of studies (e.g. Danziger, *et al.*, 1982 and Shoven and Hurd, 1982), then they should be expected to bear a proportionate share of the increased cost of their support. However, it will be difficult to bear a share of increasing costs if elderly income declines with age. But, if the assets of the elderly do not decrease while their income falls, then perhaps their contribution for their own support should come from their assets when their estates are settled. This also may be a demographically and economically sound means of supporting the elderly given the differences in the sizes of the elderly and working-age cohorts for at least the next 100 years.

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