Connections Between Income and Wealth: Comments

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■ Comments on Art Kennickell's Paper

As usual, Art Kennickell has written an elegant, easy-to-read paper, delivered to me in timely fashion. These are all big pluses to any discussant!

The motive behind Art's work is, at first glance, fairly narrow: to improve the sample design of the Survey of Consumer Finances (SCF). The SCF sample design depends on the use of a proxy for net worth (defined in terms of income) as a stratifier. The SCF folks have encountered problems at the high end of the wealth distribution, so Art has been playing around with information from other sources, namely, the Individual Tax File (ITF) at SOI and data from Forbes. Yet what Art has done by "playing around" may well blaze a path for the rest of us who would like to find better ways to model the relationship between income and wealth.

Essentially, Art uses the Forbes data on wealth for the upper strata and SCF wealth data for everyone else. Then, he constructs various wealth indices (cutely named WINDEXes) from the wealth data and the ITF income data. Then, he runs a horse race among models using the different WINDEXes (and ITF income) to see how well each performs in terms of classifying households by their net worth.

All models do better than total income alone. The one that crosses the finish line first is the model with the complicated WINDEX—the one that indicates the presence as well as the amount of various types of income and that includes age, filing status, and region as independent variables.

What is nice about the paper is its clear writing, its effective display of data, and its modesty. Art is careful to point out limitations in what he does.

I have a few questions for Art about the nature of the individual observation and the measure of wealth. Then, I have some miscellaneous comments.

Individual Observation

- ❒ When you match the survey (and Forbes) wealth measures to ITF, are you doing exact matches?

- ❒ As I understand it, sometimes an observation is a couple and sometimes an individual. Do you normalize by family size? If not, should you? Even if you do normalize, suppose economies of scale exist. Then, a couple with twice the wealth (or income) of a single is really better off than the single. Might that throw off your rankings? This would especially be true if positive assortative mating exists.

- ❒ Will your method be driven by who is in the Forbes data each year? To the extent you are constructing a panel, is that a problem?

Calculation of Wealth

- ❒ You gross up income by (I think) an average return to get at estimated principal amounts. Is it worth it to think about marginal rather than average returns, because people fall in different AGI brackets? This is probably not that important, but I thought it worth mentioning.

- ❒ I do not understand why you use absolute values of rents/royalties/capital gains and other sorts of income to calculate WINDEX0. I can see in WINDEX1 that you need absolute values because you use logs, and then you have an extra term to denote whether the value was negative. But I could not see how you corrected for negative values in WINDEX0. Have I missed something here?

- ❒ This is a minor point about timing. I think 1995 was fairly free of tax changes, but I always wonder whether data simply reveal that people

are anticipating things, particularly when capital gains tax rhetoric is flying around. You probably cannot test for anticipations but will rather have to see if your models work for other years of data. I think you do find that the models are robust enough for using other data years.

Miscellaneous Comments

- Figure 5a intended to show how income and net worth are related at the "individual level." Yet it displays percentiles of distributions—unweighted for net worth and weighted for income. I am not familiar with this sort of graph, but I have trouble seeing how it demonstrates relationships for individual households.

- You point out the limitations of using data sets—SCF, ITF, Forbes—from different years. Do you have plans to go back and look at what happens if you use contemporaneous data when they come in?

- How much does Bill Gates screw things up?

- It will be interesting to see if plots and relationships are robust enough for multiple years of data, and if Art and his people can solve the issue of trusts.

One big question remains: How applicable might this methodology be to other studies of the income/wealth relationship? It seems to me it could carry over nicely (especially for anything with tax data), but I would be interested in what Art has to say.

Here is my final observation: Although I admire this work a great deal and recognize its usefulness, I had a tiny nagging feeling as I was reading the paper. Doesn't it need at least an underlying constrained utility-maximizing model of individual behavior? For instance, doesn't classification of well-being that relies on wealth ignore the folks who give a lot to charity and accumulate little for themselves? Clearly, the SCF sample design has to rely on ascertainable data, so perhaps a behavioral model has no role to play, particularly in a paper that simply tries to link income to wealth empirically. But I am curious whether the SCF design generally has an underlying model of individual behavior built into it.

■ Comments on Barry Johnson's Paper

Let me turn now to Barry Johnson's paper. Like Art's, it is succinct and well-written. I'm always delighted to see something that Barry has produced, because it is sure to be clear, to the point, and packed full of interesting stuff.

Barry's work extends SOI's important contributions to the literature on estimating the wealth of the U.S. population. He uses the estate-tax-multiplier technique to get from the wealth of the dead to the wealth of the living. What is more, he offers empirical evidence as to who has the money (demographically speaking), what sorts of assets they hold, and how these things have changed over the recent past. One of his most provocative findings is that the rich did not necessarily get richer between 1989 and 1995.

Barry has to cope with a number of issues, namely, (1) that only wealthy decedents yield estate tax returns, (2) that estate tax returns for a given year of death are filed over a much longer time period—some beyond the window of time for collection (akin to a non-response issue), (3) that wealthy people die at different rates than the overall population, and (4) that some wealth is not reported on estate tax returns. He handles all these with aplomb.

I have a few questions and comments and then a few suggestions.

Questions and Comments

- You note the sample variance problem with the young and the extremely wealthy. But aren't these different sorts of problems? Given the nature of estate tax returns, you could get all the wealthy people who died. But you cannot get all the very young because they will not all meet the filing threshold.

- Figures 5 and 6 show the top wealthholders by

age. I wonder if this information could shed any light on life-cycle hypotheses of wealth accumulation and decumulation. Those of us who have to work with cross-sectional wealth data must often correct for age or somehow come up with an instrument for "lifetime wealth." Perhaps what Barry has here could help us out.

- You note that females invest a smaller portion of their portfolios in retirement accounts. I think I could tell a story here—in part because my husband and I finally got around to finalizing our wills last week. Women tend to live longer (Barry also notes the greater proportion of inherited wealth for women), so they typically are beneficiaries of their husbands' retirement accounts. What would they do with this money? Put it in other sorts of assets. So some of what shows up in women's portfolios is actually their husbands' retirement accounts by another name. Perhaps segregating estate tax records for widows and for married women would shed some light on this point.

- Here is a minor question. Are millionaires determined in current dollars? That is, does a person make Barry's millionaire category provided he or she has a million in net worth in dollars of the year the person died? Other parts of the paper focus on constant dollars, so this point needs clarification.

- In the last section, you mention costs of final illnesses and gifts in anticipation of death. Can't we get at those in the estate tax return? I seem to remember a line item for costs of final illness and also some unification of estate and gifts given within a certain time period, but I'm not sure if my memory serves me well.

Suggestions

- Barry has a number of useful bar charts that show differences across time in portfolio holdings and in demographic characteristics. He says that some of these things change over time. I wonder if it would be possible to say whether these changes are statistically significant, perhaps by using chi-square or F tests.

- To cope with the connection between wealth and mortality rates, Barry discusses refinements to national mortality rates and the need for separate life tables. He notes that adjustments based on life-insurance data fail to separate out the sexes, so he uses the National Longitudinal Mortality Study (NLMS) instead. This section is a little murky—I wasn't exactly sure how the NLMS was used, nor did I quite understand what figures 1 and 2 meant (especially how the "differential" line was calculated). I also wondered if Art's work could come in handy, because the NLMS has income and occupational information rather than wealth information.

- Another rather cryptic part of the paper was the discussion of the use of the Pareto distribution rather than post-stratification to correct for using gross assets rather than net worth. I was a little puzzled by this—given that Barry actually does use net worth to separate out millionaires—so I was not clear as to what the problems are with using net worth instead of gross assets as a grouping variable.

- Although the information on macroeconomic changes was interesting, it was not tied in as clearly as it might have been to the point of this paper.

One last point: Barry's paper is based on individuals. Art works with households. This brings up the eternal conundrum—what is the best unit of measure for determining well-being? Is it the individual? The household? The extended family? Particularly for Barry's paper, I am wondering if it is entirely legitimate to group together, say, millionaires who have no dependents with millionaires who have many. Are they really in the same "well-being" ballpark? This is a question that anyone who works with income and wealth has to grapple with, so I simply toss it out for contemplation.

Thanks for your attention and thanks for letting me comment on two terrific pieces of work.