WEALTH AND PUBLIC POLICY: THE RELEVANCE OF SIPP AND A PROGRAM FOR FUTURE RESEARCH

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Why Do We Need to Know?

The United States is now more ignorant of the distribution of family wealth than it has been at any time in the last 30 years. The prospects of any improvement in this state of knowledge are dismal. Our ignorance of the wealth and welfare of the American family is likely to become worse as private wealth escapes to fiduciaries who channel incomes to the sick, retired, and survivors of current breadwinners. It is likely to become worse because the fulcrum for measurement of size distribution--the Federal estate tax--has been displaced to give leverage on only a trivial proportion of wealth holders in the US. Furthermore, the tidal wave of privacy legislation has so engulfed us that it is impossible to pursue information pertaining to the lifetime earnings of the dead through Social Security.

Why do we need to know about the distribution of family wealth? Because wealth is the key to understanding a number of vexing policy dilemmas that we currently face:

(1) The most obvious is the poverty question. Is annuitized wealth greater than the difference between the poverty line for a family and its earnings? (David (1969), Weisbrod and Hansen (1968)). This is the question that the Council on Aging, has investigated in relation to the "Asset-testing" involved in SSI and on which it finds no satisfactory answer, in part because the data are lacking. (Council on Aging, 1977).

(2) Is retirement wealth adequate? This is the second question for which major policy concerns have been raised in the last four years. Charges that private saving has been displaced by social insurance (Feldstein, 1976), that contingent claims permit some to accumulate vast stores of wealth from double-dipping in government pensions, that others are laid destitute by bankruptcy of their employers or badly timed layoffs litter the public policy arena of the last decade. Systematic understanding of the linkage of such contingent claims and their joint distribution with private household wealth is non-existent.

(3) Is estate wealth concentrated? This third question is the one on which we have the best data, but the most recent findings pertain to the beginning of this decade. The effect of inflation, a major period of blues in the stock market, and rising real incomes are not known. Furthermore, the Tax Reform Act of 1976 assures that we will not recover information on the size distribution of estates from Federal data in the future because the law so badly truncates the distribution. Whereas the prior law required enough estate tax filing that we were able to estimate wealth components and its distribution for 9 million top wealth holders, the current law would have allowed a look at less than the top million wealth holders--a group that can not tell us anything about middle class wealth holding. (Statistics of Income, 1973). Although inflation will reduce truncation of the sample, a large window for observing wealth has been screened off from view by the new law.

(4) A fourth question, one that is crucial to the continued health of our country, is: At what rate is entrepreneurial wealth growing? The answer to this question depends on the fortunes of thousands of small businesses around the country. Some of these businesses are "underground," seeking to evade taxation. Others are casual, due to a more leisurely life style that was adopted by many young people at the end of the last decade. Still others are sole proprietorships and partnerships that are unlikely to provide good data to official government requests because management time is so limited and records are not always accessible. Yet much preferential tax legislation, some loan programs, some employment and investment incentives have been directed at this group. Why? How effective are these provisions? We don't know and we won't know. We do not undertake adequate measurements of the changes in the family wealth associated with people before they embark on business ventures, while they conduct such ventures, and after they get out of such ventures.

(5) A fifth question concerns tax avoidance. We all recognize that tax avoidance behavior is the inevitable product of high tax rates. At the macro-level we have monitored the accumulating avoidance behavior through the annual report on tax expenditures (Joint Economic Committee, 1978). Only recently has the locus of the recipients of such tax expenditures in the income distribution been publicized through the US budget document. Only a fifth of the value of tax avoidance in the capital gains area accrued to persons with less than $50,000, for example. This is the first clue that we have as to the truth of the adage. "Them as has, gets." For the future it is vital to be able to monitor the sources of accretion to wealth and determine to what extent they are capricious results of lacunae in the process of taxation and the vagaries of inflation, rather than the careful attention to management by motivated entrepreneurs and risk-takers.

For each of these questions there is no substitute for the knowledge of the distribution of non-human wealth among individuals, and for reasons I will explain shortly, among families. Absent information on the wealth distribution and it is impossible to know whether the aims of progressive taxation are defeated by the weaknesses of its execution. It is impossible to know whether the rate of birth of new enterprises is inhibited by lack of venture capital in the household. It is impossible to forecast the size distribution of resources that will be controlled by the next generation of retirees. It is impossible to know the change in the economic inequality of our society or to ascertain the need for asset testing to avoid a needless tax burden on a middle class committed to support of the poor.

What Information is Critical?

Much of the disrepute into which the measurements of wealth have fallen may be ascribed to a lack of understanding as to what it is that we need to know. The poverty question, the retirement question, and the question concerning birth of entrepreneurial enterprise all require knowledge of a distribution of the size of assets less debts held within a family unit. Knowledge of the patterns of asset acquisition and their disposition over the life cycle are crucial. Precision in the measurement of the tails of the distribution of components of the balance sheet are not as essential as assembling information on the orders of magnitude as to who has what kinds of property rights and who has accumulated sufficient wealth to exercise non-trivial decisions on the future development of American enterprise.

We also need to know how much of the wealth of typical American families resides in contingent claims evidenced by pension rights, life insurance, and expected intergenerational transfers.

In looking at wealth we do well to remind ourselves that great interest attaches to what the family invests directly in physical capital and real property, that it is important to understand the investment in durable goods for facilitating home production, and that the remaining financial assets must be measured along with family debts to get a clear picture of the net wealth of the family.

For questions pertaining to tax avoidance and the concentration of wealth it is no longer so important to have an emphasis on the family as a unit of measurement nor to understand the context of household possessions and their relationship to wealth holding and saving. For these two questions emphasis in measurement must be on the tail of the distribution--What happens to people with extremely large wealth? How many are there? How much do they own?

Thus I judge that there are a large number of important questions for which an understanding of the holding of wealth in the family, the holdings of wealth from median levels to the 90th percentile, and knowledge of the joint distribution of wealth components and contingent claims are particularly useful. At the same time it must be recognized that some questions having to do with wealth can not be usefully answered without precision in the estimation of the upper tail of an extremely skewed distribution.

This leads to my next observations.

What Inhibits Observation of the Distribution of Wealth?

1. Sampling. Area-based sampling of the population will never produce reliable measures of the mean of wealth components or their aggregates. Such sampling will not produce accurate measures of the concentration of wealth and the skewness of the distribution of wealth. For these statistics it is essential to have access to a sampling frame that can be stratified by income, and more particularly by income derived from wealth.

2. Motivation. Sampling is not the biggest obstacle to wealth measurement however. Motivation to report wealth is surely the biggest problem. Many individuals feel that they have no identity apart from their possessions--and a report of their possessions to an outsider threatens their security. (How many of you have been accused of being promoters or salesmen in the course of work as an enumerator or interviewer?) Worse than that, wealth associated with less than perfectly honest dealings needs to be hidden from the prying eyes of tax assessor or potential prosecutors. The psychology of wealth holding from smallest to largest owner is that information is valuable, it is likely to be costly and self-destructive to give it out, and there are few reasons to trust the casual intruder who claims to be engaged in wealth measurement activity.

Mix these motives with abuse of personal data over the last thirty years and a history in which individuals did not know what might be compiled into credit or other dossiers and you have the current national mood that data collection on wealth is illegitimate and an invasion of privacy.

3. Knowledge. Apart from negative motivations, much of the problem in wealth measurement has been a lack of knowledge on the part of the respondent. Some individuals do not think or understand what it means to organize family financial information into a balance sheet. Others can appreciate the concept but their records are not conveniently available. Still others have legal power over assets that are not spiritually theirs; they are custodians for minors or aged persons and do not conceive of those assets as part of the family stock of wealth. Indeed one of the major deficiencies of past wealth studies has been the attempt to acquire all financial data from a single proxy respondent. In many cases the proxy simply does not know about the financial affairs of all family members for whom he/she is to report.

I have identified some essential policy questions that need to be answered with wealth data. I have pointed to three major obstacles to the collection of such data: sampling, motivation, and knowledge. Now I will suggest some solutions, and some directions for experimental research on wealth measurement.

Solutions--Directions for Research

1. Sampling

The policy questions described earlier make clear that two different types of sample are required. An area-based probability sample of the household population will probably suffice to understand the wealth-related behavior of families up to a level of those with three or four times the median income. Beyond that level a highly stratified sample of top-wealth holders is essential.

The value of the sample of the population will be enhanced by stratification on income. This can conveniently be accomplished through screening carried out in connection with a continuing panel, such as the Current Population Survey, or by the extraction of a list of names and addresses by known rates of selection from tax rolls, as was done by Barlow, Brazer and Morgan (1966).

The top wealth holder sample can only be derived from tax return data files. In the past estate tax returns have been used to develop wealth estimates for the living. In the future a great deal more can be done with income tax records, now that more effective control on the reporting of interest and dividends makes it possible to see a larger proportion of financial wealth reported on the tax return. (Using such data Bussmann, 1972, was able to reconstruct values of portfolio gains for Wisconsin residents over the period 1947-64.)

What is lacking in both types of samples are devices for linking the data to other sources for validation and the creation of estimates that do not suffer from truncation biases. Based on our experience with the Wisconsin Assets and Income Studies (David, et al., 1974) it seems essential to move in the direction of linking population samples to information derived from administrative records of financial institutions that are sampled on the basis of alphabetic clusters (or alphabetic clusters and Social Security account numbers). Ferber conceived of this sample design in the mid-1960s and the idea must be reviewed in relation to necessary legal protections for the individuals involved and the possibilities for capturing as many types of validating information as possible for the individuals under study.

What is also lacking is continuity of the samples over time. A continuing study of identical taxpayers with high income from property and owned enterprises would serve two functions: (a) the wealthy could effectively be differentiated over time from middle class with occasional windfalls; and (b) following the wealthy during their lifetimes and linking probate and estate data to the decedents in that sample would produce more accurate estimates of lifetime wealth than would be possible by application of the estate-tax multiplier method.[1]

2. Motivation. Improvements in sampling are necessary to better wealth estimates, but they are not sufficient. Understanding and overcoming the motivations that lead to refusal, item non-response, underreporting, and overreporting are essential. What is needed to improve motivation is a program with four elements.

(a) validation--to enable one to determine the relationship of reports to a true value that is to be captured for policy analysis;
(b) psychometric measurements--on the threat posed by revelation of wealth position, debt, and associated income;
(c) consumer research--on how families conceptualize their financial situation and how they understand their property rights and liabilities;
(d) experimentation--to allow the controlled variation of conditions of data collection that affect motivation.

I will discuss these elements in reverse order.

(d) Manipulation of the conditions that affect motivation has the promise of producing an order of magnitude of improvement in the reporting of net worth in household surveys. Recent research at the University of Michigan has demonstrated that respondents are not generally aware of what constitutes an adequate report, they must "learn" the role of respondent. The efficacy of teaching the respondent what constitutes quality data, of obtaining a contractual commitment to supply data, and of motivating the use of records has been demonstrated by Cannell (1977) in studies of health measurement. (Only record use has been studied in connection with financial measurement.)

Manipulation of the conditions of reporting is also important because psychological theory dictates that the respondent must be rewarded for the difficult task of retrieving information that is not well structured in his/her cognitive framework and for which data are not easily recalled. The reward necessary may be a substantial sum of money--it would be worthwhile experimenting with bonuses several times the cost of the data collection (i.e., $200-300) to determine the impact on validity, and response.[2] It may be more cost-effective to experiment with reports to the respondent that create useful feedback for consumer decisions and financial management. A sizeable fraction of consumer units have no clear idea of their net worth--a carefully prepared balance sheet will be useful information for their saving and asset management decisions. Other families will have a clearer idea of their net worth, but will have little idea of how to assess their risk position and the need for insurance to cover assets against contingencies. Still other families will be concerned about a reasonable program of saving for college expenses of young children, for the desirable insurance program to cover the loss of the major breadwinner, or for the rationalization of debt and accumulation of liquidity for major durable purchases.

(c) The need for the third element of the experimental program is now clear. We need to know how families think about their finances to be able to supply them with information that they would find sufficiently rewarding to give better reports.

Imagine what such a measurement program might entail. The enumerator arrives on my doorstep. I can't find all the necessary information. After a week computer report of the information available is returned to me for checking. Missing items are filled in and others are corrected. A second report is returned to me.--A Financial Report for the David family. In it I find:

(a) A calculated summary of assets and wealth.
(b) A statement of the level of additional credit that it would be safe for my household to carry.
(c) A report on the excess or deficiency of insurance that I am holding.
(d) A measure of the sinking fund that I must establish if I wish to finance more than half of my children's expenses at a private college.
(e) A measure of the adequacy of my financial management and the likely steps that I could take to improve that management.

With present technological capabilities, the knowledge of the insurance industry, financial institutions, institutions of higher education, and the resources of credit bureaus and financial counselling services it is possible to assemble a tailor-made report for every participating family. The difficulty is to determine what information is crucial for decisions that families are currently required to undertake and to focus the report on the kinds of information that families will find valuable.

(b) The need for psychometric measurement is also important as we understand very poorly what causes refusals and non-response. Is it an ideology of "privacy" in which a societal need for information has no place? Or is it an immediate threat that arises from paranoia? Or is it fear aroused by potential retribution from the law for illegal activity? Distinguishing these causes of non-response may give us better means of estimating the missing elements of the wealth distribution.

(a) Lastly, validation is essential. Few clues in an enumeration or interview situation predict mendacity--Rounding of figures, parental family unwillingness to discuss money matters with children and refusal to consult records are the only indicators (Ferber and Frankel, 1978). Without a means for detecting inconsistency in the enumeration forms, it is essential to have a calibration formula to adjust reports received to true values. (What is required is information such as is reported by Ferber, et al., (1969a, 1969b) in their path-breaking studies.)

3. Knowledge. Much progress can also be made on increasing the accessibility of information to respondents. Firstly, the use of proxy adults to report on assets and debts is doomed to failure. Husbands keep knowledge of finances from their wives (and vice versa); children over 18 are legally entitled to manage their own financial affairs including contracting for debt and accumulating savings in places unknown to the parent. Guardianships and powers of attorney for aged persons are a special problem that requires a direction to each adult to report for all the assets over which he/she has legal control.

Secondly, a panel format to data collection makes it much easier for the respondent to acquire the necessary records from accountants, the safe, or forgotton filing places so that access to records can be programmed into the data collection scheme.

Thirdly, given a high level of motivation that can be induced by the feedback and monetary incentives suggested above, it should be possible to obtain rather general release of data from employers, financial agents, pension funds, and other sources to enable the wealth study to tap the contingent wealth sources available to the family.

Relevance to SIPP

Two of the five questions outlined at the beginning of this paper are of direct concern to the policy makers sponsoring SIPP (the DHEW experimental survey program for measuring income and eligibility for program participation). The survey is concerned about identifying poverty and non-participation in HEW programs designed to improve the welfare of the population. One of the policy concerns is that a "target group" has been too broadly defined and that those with adequate wealth are reaping excessive benefit from a program designed for others. This concern requires a crude measure of wealth. SIPP's concern for the retirement resources of working people requires a measure of contingent wealth.

Because of this need to understand the joint distribution of income and wealth it is clear that the sponsors of SIPP should take an interest in the strategies that I have outlined:

(1) Care must be taken to see that population samples can be linked to administrative records (particularly tax records) that will give clues about wealth position. (See also David, 1976)

(2) A program of experimental measurement on wealth should be undertaken. The enumerator is now faced with measurement using a process that fails to arouse the motivation of the respondent and thereby fails to produce comprehensive response.

(3) A revival of validation studies is essential so that respondent behavior in the 1970s can be calibrated against the current system of financial recordkeeping, much improved over that of the last decade.

It is likely that real progress towards improved wealth measurement will not come via a single program. It is important to simultaneously develop methods of estimating from direct collection of family data and methods that extrapolate from administrative records. The interaction between these two methods is particularly important in the case of wealth measurement as we know that interdependent sampling of individually collected data and the power of stratification in administrative records will produce far more accurate statistics on wealth than the attempt to acquire wealth data by random selection.

FOOTNOTES

[1] Paul Menchik and I are now embarking on such a study in Wisconsin, looking retrospectively at income reported for 1947-64 for decedents since 1947.

[2] An excellent review of present knowledge about compensation appears in Ferber and Sudman (1974) and Cannell and Henson (1974).

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