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Medical Savings Accounts Would Work for Most Employees

In the ongoing debate over health care policy, many participants have advocated employer-funded medical savings accounts (MSAs) in conjunction with catastrophic health insurance. Recent legislation provided favorable tax treatment for medical savings accounts for the self-employed and employees of small firms. Under such plans, insured workers would be responsible for a high deductible each year, which would be paid using the accumulated balance in their MSAs. Any amount not spent would remain in their MSAs, and could be withdrawn upon retirement. By causing employees to spend more of their own money on health care, this plan would reduce the tendency to overspend; the result would be less overall spending on medical care than today.

Critics of MSAs have argued that people who are sick one year also tend to be sicker than average throughout their lives; therefore, many sick people would accumulate no assets in their MSAs. A recent NBER study shows that this problem is not as big as many critics have thought.

In **Insurance or Self-Insurance? Variation, Persistence, and Individual Health Accounts** (*NBER Working Paper No. 5640*), **Matthew Eichner, Mark McClellan,** and **David Wise** use data on family medical expenses of over 300,000 employees at a *Fortune* 500 company from 1989 to 1991 to estimate the balances that would accrue under a system of MSAs. They confirm that people who spend a lot on health care in one year are much more likely to be high spenders in the following two years. Almost 60 percent of the workers who were in the top fifth of health care spenders in 1989 were also in the top fifth for the three-year average of 1989, 1990, and 1991. Another 35 percent of those in the top fifth for 1989 were in the second-highest fifth for expenditures averaged over three years. By contrast, fewer than 10 percent of the people in the lowest-spending fifth in 1989 were in the highest fifth for the whole three-year period.

But Eichner, McClellan, and Wise also find that even though average spending for high first-year spenders over the three-year period was higher than the average for all employees, their spending declined in the second year and fell further in the third year. This suggests that health care spending of the employees with the sickest families tends to diminish over time; thus, even the sickest may accumulate some savings in their individual health accounts.

Using data on health care expenses, the authors estimate how large employees' MSA balances would be at retirement. The researchers assume that employees would work from age 25 to 60, that the employer would put $2000 in each employee's MSA at the beginning of each year, and that the catastrophic health insurance plan would have a $4000 deductible. Given these assumptions, the authors find that about 90 percent of the employees would have accumulated over $25,000 by retirement age. Seventy-five percent would have more than $40,000, and 50 percent would have more than $50,000. Only about 20 percent of

"[A]bout 90 percent of the employees would have accumulated over $25,000 [in MSAs] by retirement age."

the employees would have saved less than half of their contributions, and only 5 percent would have saved less than 20 percent. On the other end, fully 50 percent of employees would have kept more than 70 percent of their contributions.

In reaching these conclusions, the researchers assume that spending one's own money has no impact on individual health care spending. But based on other research and on simple economic sense, they know that this assumption is false. Employees would spend less on health care when spending their own money. Therefore, the amounts accumulated in the individual health accounts, even for the families that spend the most, would be even larger than this research suggests. DRH

Downsizing Is an Increasing Cause of Recent Job Losses in the United States

An analysis of government survey data conducted by NBER Research Associate **Henry Farber** for 1981 through 1993 indicates that rates of job loss in the 1990s are somewhat higher than they were in the 1980s. Moreover, older and more-educated workers—including managers—have seen their rates of job loss increase more than other groups. However, the older and more educated were still less likely to lose their jobs during this period than younger and less-educated workers.

In **The Changing Face of Job Loss in the United States, 1981–93** (*NBER Working Paper No. 5596*), Farber considers three causes of job loss: 1) plant closing; 2) slack work, where an employer reduces employment because of a decline in demand but does not cease operations; and 3) position or shift abolished. He finds that the rate of job loss attributable to plant closing has been fairly steady over 1981–93. In contrast, job loss caused by slack work is cyclical: it was much less common in the strong labor market of the mid- to late 1980s than it was in the slack labor market of 1981–3 or after 1987.

However, job loss attributable to abolition of a position or shift grew from about 11–12 percent of all job loss in the 1980s to about 17 percent of job loss in 1991–3. This category of job loss always has been more common among college graduates, representing about 20 percent of their job loss in the early 1980s and growing to about 28 percent in 1991–3. While there is no direct evidence of a link, the increase in this category of job loss resonates with the well-publicized round of corporate downsizing and restructuring of the past several years.

Since 1981–3, college graduates have been relatively less likely than high school graduates to report job loss for reasons other than position or shift abolished. Since 1989, however, college graduates have become significantly more likely than high school graduates to report job loss because of position/shift abolished.

> "[J]ob loss attributable to abolition of a position or shift grew from about 11–12 percent of all job loss in the 1980s to about 17 percent of job loss in 1991–3."

The costs of job loss to employees are "dramatic," Farber finds. On average, about 36 percent of displaced workers were not employed at the time of the next government survey after their displacement, a lapse of anywhere from one month to 36 months. Those with a college education were more likely to be employed, with 22 percent jobless at the next survey, versus 38 percent of those with a high-school education.

Also, it was harder to get a job in the recessionary periods of 1981–3 and 1990–1, Farber finds. But there is no evidence that employment probabilities declined otherwise over the entire period. In fact, workers who lost their jobs because a position or shift was abolished found it easier to get another position in 1991–3 than they did earlier.

The decline in real weekly earnings for those who have lost a job and found another averages about 14 percent. But that figure includes those who find only part-time work. For those who move from full-time work to full-time work, the earnings loss is about 9 percent. In addition to working fewer hours, they often are paid at lower wage rates. The college educated suffer smaller proportional declines in earnings on average: about 6.2 percent for those moving from a full-time job to another full-time job, versus 8.6 percent for high-school graduates.

Many who lose their jobs decide to become self-employed, launching their own businesses or consulting activities. The self-employment rate is about 7.3 percent among those who had been working for someone else when they were let go, versus 8.5 percent in

the work force as a whole. College graduates are more likely to be self-employed than are high-school graduates: 10.1 percent versus 6.4 percent. Older workers are more likely than younger workers to choose the self-employment route after being laid off.

Farber also shows that the costs of job loss are countercyclical: the losses are smallest during an expansion with tight labor markets and largest during a recession with slack job markets. But he finds no evidence that the costs of job loss have increased systematically over time. Further, there is no evidence that job loss attributable to position or shift being abolished has any more or less serious consequences than job loss for any other reason.

DRF

Warning! High Earnings Are Bad News for the Stock Market*

The dividend/price ratio on the S&P 500 now stands under 2.2 percent, nearly the lowest level in recorded history. By some calculations, stock prices are higher relative to dividends than they ever have been, going back to 1871. At the same time, the price/earnings (P/E) ratio is about 19, high but not atypical. For those worried about an overvalued stock market, these robust earnings should be a source of comfort, right? Wrong! According to NBER Faculty Research Fellow **Owen Lamont,** if you believe that the dividend yield and P/E ratio have predictive power for the stock market, then today's high earnings should bring you grief and not joy.

In **Earnings and Expected Returns** (*NBER Working Paper No. 5671*), Lamont writes that postwar data on earnings, dividends, and returns on the stock market tell the story. It turns out that, given the dividend yield, high earnings today imply lower future returns on the stock market tomorrow. If you have access to a standard computer spreadsheet or other software that can run regressions, and the past 30 or so years of stock market data on prices, earnings, and dividends, you can check the numbers yourself, he emphasizes. If you put both the P/E ratio and the dividend yield into a forecasting equation for returns on the stock market in excess of the T-bill rate, you will find that the P/E ratio is correlated positively with future returns.

Why are high earnings an omen of low returns? No one really knows, but we can make some guesses. Economic theory suggests that risky assets should earn lower returns in booms and higher returns in recessions. Another explanation hinges on "fads" and fashions in the stock market. Maybe people are irrationally optimistic when earnings are high; consequently, the stock market becomes overvalued and must fall.

In any event, the data have a single message: don't be comforted by high earnings relative to dividends. The best time to buy stocks is when prices and earnings are low, Lamont concludes, as they are in a recession. The worst time to buy stocks is when prices are high and earnings are high, as they are right now.

Of course, there is another alternative. You could choose to stop trusting dividend yields and price/earnings ratios altogether. Maybe it's just a fluke that these variables worked in the past, and thus they will be unreliable in the future. After all, people following these forecasts of stock returns would have missed the 1995 boom in stock prices altogether.

Economic theory tells us that the stock market should be very hard to predict, and it is. Like everyone else foolish enough to try, academics have a poor record at predicting the stock market. In 1929 Irving Fisher, one of the greatest American economists of his era, predicted that stock prices were at a "permanently high plateau."

"Maybe people are irrationally optimistic when earnings are high; consequently, the stock market becomes overvalued and must fall."

**This summary was prepared by Owen Lamont, NBER and University of Chicago.*

Legalized Abortion Reduced Out-of-Wedlock Births

The legalization of abortion resulted in a decline in birth rates of roughly 8 percent, according to a recent study by **Phillip Levine, Douglas Staiger, Thomas Kane,** and **David Zimmerman.** In **Roe v. Wade and American Fertility** (*NBER Working Paper No. 5615*), the four economists reach this conclusion by using the variation across states in the timing of abortion legalization in the early 1970s to estimate the effect of abortion on birth rates.

> "[O]ut-of-wedlock births declined by twice as much as births in wedlock."

They find that states legalizing abortion experienced a 5 percent decline relative to other states. The decline was greater among teens, women over 35, and nonwhite women: 13 percent, 8 percent, and 12 percent, respectively. Further, out-of-wedlock births declined by twice as much as births in wedlock.

"If legalization in some states affected birth rates in neighboring states (through travel to obtain an abortion), [then] comparing births between states will underestimate the actual reduction," the authors write. So, they use more distant states for comparison, and the estimated impact of abortion legalization on birth rates rises to about 8 percent.

Finally, when they apply this estimate (based on birth data for 1965–80) to the current level of births, the authors conclude that "a complete recriminalization of abortion would result in 320,000 additional births per year."

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