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Poverty and Mistreatment of Children Go Hand in Hand

Child neglect increases in states that cut their welfare benefit levels. This finding, in light of the recent reforms in the U.S. welfare system, is "particularly troubling," note NBER Research Associate **Christina Paxson** and **Jane Waldfogel** in **Work, Welfare, and Child Maltreatment** (NBER Working Paper No. 7343). Provisions of the reform call for reductions in benefit levels for recipients who do not work. So the children of mothers who receive these cuts "will be at heightened risk of neglect," the authors reckon.

Using state-level data on the number of reports and substantiated cases of child maltreatment, Paxson and Waldfogel find more broadly that the socioeconomic status of families does affect levels of child maltreatment. Maltreatment encompasses a wide range of behavior that harms children, including neglect, physical abuse, and other forms of abuse. Children with working mothers and absent fathers are more likely to be subject to neglect and abuse. So are children with two non-working parents or parents whose

income is below 75 percent of the official poverty level.

Paxson and Waldfogel find that increases in the fraction of children in extreme poverty result in increases in maltreatment. For example, if the fraction of children below 75 percent of the poverty line rises from 10 percent to 15 percent in a state, the number of total victims of maltreatment is estimated to rise by 22 percent.

"Children with working mothers and absent fathers are more likely to be subject to neglect and abuse."

Family structure and parental employment status matter as well. An increase from 10 percent to 15 percent in the fraction of children with a working mother and absent father is predicted to increase substantiated cases of maltreatment by 21 percent. Likewise, an increase from 10 percent to 15 percent in the fraction of children with two unemployed parents is expected to increase maltreatment by 26 percent. However, children with absent fathers and non-working mothers do not

appear to be at higher risk for maltreatment than children with two working parents, or a working father and non-working mother.

Absent fathers, unemployed fathers, and increased poverty are all associated with increased maltreatment. Poverty has a bigger impact on neglect than on physical abuse, though. If single mothers work, child maltreatment is considerably more likely, possibly because single working

mothers are more neglectful or abusive, or because their children are left in the care of someone who is neglectful or abusive. A shift of 1 percent of children from the category of "absent father, non-working mother" to "absent father, working mother" is associated with an increase in substantiated cases of physical abuse of 6.6 percent and an increase in neglect of 12.6 percent, the authors find.

This raises the issue of the impact of welfare benefit cuts on child mal-

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treatment. Where welfare benefits are relatively high, mothers may be more able to stay home and look after their children. The authors note that about half of families referred to child protective services are receiving welfare at the time of referral, and more than half received welfare

in the past. Such families tend to be poor, single parent, or two-parent with a jobless father—and the author's results indicate that families with this profile are most likely to be reported to child protective services. The authors add: "...moving women off welfare rolls onto jobs that do not

pay more than welfare could harm children." They may be stressed by their job, have difficulty making ends meet, and have less energy available to care for children at the end of the day.

—David Francis

Taxes on Wireless Services Burden the Economy

Cell phones are everywhere these days. You see people talking on their phones in cars, in restaurants, and walking along city sidewalks. The numbers confirm what your eyes observe. Since their introduction in 1983, use of wireless phones has grown at 25 to 35 percent per year, and there are now more than 69 million wireless telephones in the United States.

"Taxes on wireless phones cost the economy \$2.56 billion more than the \$4.79 billion raised in revenue."

Business believes wireless phones improve worker productivity, and consumers think they enhance personal safety. Government likes cell phones, too, but for a very different reason. "Federal, state, and local governments have seen wireless as a ready source of tax revenue while the FCC [Federal Communications Commission] has used wireless to fund new subsidy programs for wire-

less telephone usage," says NBER Research Associate **Jerry Hausman**.

To illustrate, Hausman breaks out the taxes paid by a wireless user in California: FCC taxes for the high-cost fund, universal service, and school and library internet subsidy; state, county, and city sales taxes; taxes (fees) levied by the California Public Utilities Commission for universal service (3.2 percent), emergency telephone service (0.72 percent), high cost funds (3.14 per-

cent), teleconnect fund (0.41 percent), hearing impaired fund (0.36 percent), local utility taxes (7 percent), and the federal excise tax (3 percent). Nationwide, taxes on wireless services range from 14 to 25 percent, a relatively high rate.

The economic cost of these government taxes and fees on the wireless world is substantial, Hausman argues in **Efficiency Effects on**

the U.S. Economy From Wireless Taxation (NBER Working Paper No. 7281). He finds that taxes on wireless phones cost the economy \$2.56 billion more than the \$4.79 billion raised in revenue. In other words, there is an efficiency loss to the economy of about 53 cents for every dollar raised. What's more, policymakers are considering imposing other fees and taxes. Yet prospective taxes could pose an efficiency loss of 72 cents to \$1.14 per additional dollar of tax revenue raised, he calculates. That's two to four times more expensive than tapping into general tax revenue. "The effect of these federal taxes, and the many state and local taxes on wireless, is to raise the cost to consumers, suppress demand, and impose efficiency losses on the economy," Hausman writes. Federal and state regulators should take into account the efficiency effects of their actions on the economy, he concludes.

—Chris Farrell

How Government Spending Slows Growth

Fiscal expansions sometimes have contractionary effects on the economy, and fiscal contractions may result in economic expansion. To understand why, we need to investigate the effect of fiscal policy on business investment. According to

NBER Research Associate **Alberto Alesina, Silvia Ardagana, Roberto Perotti, and Fabio Schiantarelli**, increases in public spending can hit company profits and thus lead to a reduction in private investment and economic growth. Cuts in public spending, on the other hand, can lead to more private investment, and

faster growth.

In the standard textbook case, fiscal expansion boosts aggregate demand and leads to an economic expansion; a fiscal squeeze leads to a slowdown. In **Fiscal Policy, Profits, and Investment** (NBER Working Paper No. 7207), Alesina and his coauthors push deeper,

though, analyzing the experience of a number of OECD countries to explain why these standard predictions do not always hold. Most research into the effect of large fiscal swings on the economy has concentrated on the impact on private consumption. But fiscal expansions and contractions, the researchers say, have a much larger impact on private investment—and this accounts for the larger part of the response in terms of economic growth.

During the last 20 years, there have been radical shifts in the fiscal stance in many OECD countries. In the 1970s and early 1980s, these were largely the result of fiscal profligacy leading to the accumulation of large fiscal deficits. Since the mid-1980s, several large OECD economies have implemented major fiscal adjustments to slow the growth of public debt. Alesina and his coauthors use panel data over this period for 18 OECD countries, including the United States, Canada, Japan, the United Kingdom, Germany, France, and Italy. They focus on the role of profits in determining current and expected investment.

Changes in public spending and taxation affect corporate profits, and thus private investment, the researchers find. Changes in public spending have a bigger impact than tax changes do. Particularly important are changes in the public wage bill and in government transfers. This is because the labor market is the main channel linking these effects of fiscal policy on growth. Higher wages cut into profits, reducing investment, and as a result, economic growth.

Increases in public wages also can push up wage demands in the pri-

vate sector, both in unionized and non-unionized labor markets. Increases in the number of public sector jobs lead to tighter labor market conditions and increased wage pressure. More generous government transfers to those who are out of work can also bid up private sector wages. The opposite holds for cuts in public wages and public employment.

The magnitude of these effects, the researchers find, is substantial. A reduction by 1 percentage point in the ratio of primary spending to GDP in the sample OECD countries leads to an immediate increase in the investment/GDP ratio by 0.16 percentage points. It leads to a cumulative increase by 0.5 percentage points after two years and by 0.8 percentage points after five years.

“...the labor market is the main channel linking these effects of fiscal policy on growth. Higher wages cut into profits, reducing investment, and as a result, economic growth.”

This effect is particularly pronounced when the spending cut is achieved through lower government wages. A cut in the public wage bill of 1 percent of GDP leads to an immediate increase in the investment/GDP ratio by 0.51 percentage points, by 1.83 percentage points after two years, and by 2.77 percentage points after five years.

Increases in taxes also reduce profits and investment, but the magnitude of these tax effects is smaller than those on the expenditure side. As with spending, it is the change of fiscal policy with regard to labor markets that has the strongest effect. On the tax side, workers in the private sector may react to tax hikes by

demanding higher pre-tax wages or by working less. This puts pressure on profits and investment (with cuts in labor taxes having the opposite effect). An increase in labor costs equal to 1 percent of GDP leads to a reduction in the investment/GDP ratio of 0.17 percentage points on impact. After five years there is a cumulative reduction of 0.7 percentage points.

The difference in the size of these expenditure and taxation effects suggests that the composition of any large swings in the fiscal stance is crucial. Fiscal expansions tend to be implemented largely through spending, particularly on public sector wages government and transfers, with larger effects. Contractionary adjustments, on the other hand, are characterized mostly by tax increases,

where the effect is likely to be smaller.

The magnitude of these coefficients suggests that there is nothing special about the behavior of investment at times of large fiscal adjustments—and so there is need for special theories to explain the effects of large fiscal adjustments. The estimated effect of spending and taxes on investment imply that the different composition of the stabilization package can account for the observed differences in investment and growth rates, and for the surge in private investment that accompanies large public spending cuts.

—Andrew Balls

What Determines Quality Health Care, and How Can We Measure It?

Issues of performance and quality in the delivery of health services

are critical to assessing the effectiveness of different health care providers and to evaluating different health policies. However, policy-

makers and care providers have not had adequate measures of quality available because of the inherent problems in gathering timely and rel-

evant data, the fact that medical care has so many dimensions, and because so many factors aside from provider quality affect patient outcomes.

In **The Quality of Health Care Providers** (NBER Working Paper No. 7327), authors **Mark McClellan** and **Douglas Staiger** describe a systematic approach to assessing hospital quality which overcomes many of the key limitations of existing methods. First, it reduces measurement costs by isolating particular combi-

nations of indicators that provide a truer measure of quality at a hospital. Second, it performs better than alternative approaches in reducing the problem of "very noisy" measurements resulting from small patient samples and large numbers of factors outside the health care system affecting patient outcomes. Finally, the authors' approach allows them to make better predictions about the current and future quality of providers than existing methods do.

"After adjusting for other differences between market areas, the mortality measure indicates that for-profit hospitals offer better quality."

ease in elderly Americans, the successful treatment of which is highly dependent on quality care. They find that differences across hospitals in short-term mortality rates following a heart attack, adjusted for patient demographics, are excellent indicators of the quality of care. Those rates vary dramatically across hospitals, with differences that are persistent over time, and are highly correlated with alternative indicators of quality.

Using the same methodology and data on patient outcomes from 1984 to 1994, the authors attempt to compare quality between for-profit and not-for-profit hospitals. In **Comparing Hospital Quality at For-Profit and Not-for-profit Hospitals** (NBER Working Paper No. 7324), they observe that, on average, for-profit hospitals have higher mortality among elderly patients with heart disease, and that this difference has grown over the past decade. Not-for-profit hospitals perform better with elderly patients with heart disease,

even after adjustments are made for differences in hospital size, teaching status, whether the hospital is in a city, and patient demographics. Much of this difference is attributed to the location of the for-profit hospitals, though.

For-profits tend to locate in areas with higher costs and worse outcomes. Not controlling for these area effects, it would look like they tend to have somewhat higher costs and worse outcomes—an error commonly made in the literature. Within the areas where they locate, they tend to do a little better than average on both.

In other words after adjusting for other differences between market areas, the mortality measure indicates that for-profit hospitals offer better quality. More striking are the differences in mortality rates within each hospital ownership type. The authors examined three market areas with varying for-profit/not-for-profit hospitals within them, resulting in a sample of 3,718 hospitals. Overall, the authors' analysis suggests that factors other than profit status may be the main determinants of quality care in hospitals.

—Lester A. Picker

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