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# Does the balance of power within a family matter? The case of the Retirement Equity Act

Saku Aura

*Department of Economics, University of Missouri-Columbia, 118 Professional Building, Columbia, MO 65211, United States*

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**Abstract**

This paper studies within-family decision making regarding investment in income protection for surviving spouses using a simple and tractable Nash-bargaining model. A change in US pension law (the Retirement Equity Act of 1984) is used as an instrument to derive predictions from the bargaining model about the household demand for survivor annuities and life insurance and to contrast these with the predictions of the classical single-utility-function model of the household. In the empirical part of the paper, the predictions of the classical model are rejected in favor of the predictions of the Nash-bargaining model.
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## 1. Introduction

Most economic theory assumes that household behavior is determined by a rational agent maximizing a single household utility function. This means that the behavior of multiperson household can be described as decisions made by a (possibly benevolent) dictator within a household. For most purposes, this assumption has been proven to be

*E-mail address:* auras@missouri.edu.

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powerful way of describing actual behavior, but in certain applications it is important to consider explicitly the multiperson nature of many households. This paper considers one such application: the analysis of a government policy intended to redistribute resources within a family.

The specific issue analyzed in this paper is a married couple's choice of the amount of survivor protection to be provided to a surviving spouse after the death of her partner.[1] The potential conflict of interest between spouses rises from the fact that providing protection to a surviving spouse is costly (e.g. life insurance is not free). This means that the more survivor protection is provided, the less resources the household has available in other states of the world. Thus there is the potential for conflicting interests between spouses.

The application studied in this paper is the spousal signature requirement of the Retirement Equity Act (REA) of 1984. This requirement mandated that a married pension plan participant, when retiring, must choose his pension payment in a form of a joint-and-1/2 survivor annuity unless his spouse signs a notarized consent form waiving her right to this survivor protection.[2] The mandate affected only pension plan participants who started receiving their pensions after January 1, 1985.

In the theoretical part of the paper, a Nash-bargaining model of family decision making is used to analyze the specific effects of this law change for the selection of survivor annuities and life insurance holdings. The law change is interpreted as having changed spouses' relative outside options. The model predicts that the law change would increase the selection of the survivor annuities and increase life insurance holdings for most households. These predictions of the Nash-bargaining model are contrasted with the stark prediction of the classical model that the law would have had no effect since the household budget set is unchanged. Thus this exogenous law change provides a well-identified empirical strategy for testing the predictions of the bargaining model against the predictions of the classical model.[3]

In the empirical part of the paper, several cross-sectional datasets are used to study these predictions. The effect on the survivor annuity selection is studied using the Current Population Survey (CPS) December 1989 Pension Benefit Survey and a combination of

[1] From now on, we will use convention that the husband is the spouse who, having been the primary earner, is more likely to die earlier. While the reverse situation is relevant for some couples, this is still (especially for the cohorts used in the empirical analysis) overwhelmingly more typical. The law change that is studied in this paper, while written in gender-neutral terms, was explicitly targeted to increase the protection of widows after the death of their husbands.

[2] A joint-and-1/2 survivor annuity is an annuity that pays a fixed income stream as long as the primary annuitant (the pension plan participant) is alive and 50% of this stream as a survivor benefit for his spouse after his death as long as she is alive. A typical alternative to the survivor annuity is a single life annuity that pays a higher fixed income stream during the participant's lifetime. The terms "joint annuity" and "survivor annuity" are used interchangeably in this paper.

[3] Most of the existing literature that tries to test between alternative models of household behavior use as their identification sources variables that could easily be interpreted as being endogenous to the decision (like the relative income shares of the husband and wife). Thus, the rejections of the classical model in these papers can be due to this problem of identification strategy. Two exception are Duflo (2000) and Lundberg et al. (1996). In the former, the natural experiment was an expansion of pension benefits in South Africa. In the latter, the natural experiment was a policy change in the UK, which changed the Child Benefit from tax credits to a direct payment to the mother. Both papers reject the classical single utility function view of the household.

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