Behavioral Responses to Wealth Shocks: Evidence from Swedish Portfolios

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How do workers prepare for retirement as their financial situation changes? How does wealth affect earnings and health before and after retirement? How quickly do people spend down newfound wealth rather than saving it? The paper brings new evidence to the fore on these fronts, using the wealth shocks from capital gains over the universe of household portfolios in Sweden.

It is challenging to answer these questions because it is hard to find unpredictable, unforeseen changes in wealth. The main research design exploits the unique Swedish environment with complete portfolio information on every resident for the years with a wealth tax in effect, from 1999 to 2006: By using baseline portfolios of publicly traded assets and revaluing all assets at subsequent prices, using only their risk-specific excess returns, the simulated wealth changes are unpredictable (as much as financial markets are efficient) and still correlated with actual wealth at a later point. Thus, we can identify wealth effects from precise cross-sectional variation.

With this instrument, we separate an unpredictable part of wealth, and we test whether wealth shocks cause earlier retirement, less savings (or even earnings) before retirement, or better health once retired. We also investigate how wealth (and any wealth shock in particular) is spent down before or after retirement. We then document how the effects dissipate in the family: whether spouses treat each other's wealth as their own, but also some novel work going beyond the household.

Importantly, the wealth records are not only detailed but also comprehensive; thus, we see which assets the newfound wealth was invested in, or which they crowded out, as much as the portfolio was rebalanced. Moreover, remarkable hospitalization, outpatient care, and prescription records allow us to see whether positive wealth shocks help people stay healthier, or potentially how negative shocks make life unravel.

More descriptive work establishes wealth inequality in Sweden and how it related to the inequality of these returns, as well as differential effects for individuals of different cognitive ability by military enlistment records for males born between 1951 and 1979.