Discussion of Heathcote, Storesletten, Violante Consumption and Labor Supply with Partial Insurance: An Analytical Framework

by

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Background/Motivation

A large literature documents changes in the dispersion of earnings in the US and other countries (Katz-Murphy ....).

Subsequent work dissects these changes, e.g., between vs. within group, permanent versus transitory, etc...

Two follow-up literatures motivated by this observation:

- What is the cause of the change in dispersion?
  - changes in technology? institutions? policy?
- What are the consequences of the change in dispersion?
  - changes in dispersion of consumption? hours? utility?

A question which has received little attention:

What do efficient responses look like?

This Paper

- This paper seeks to determine the change in consumption dispersion that has accompanied the change in *wage* dispersion.
- If we had “good” data on individual consumption over time then this would be a simple matter of reporting some moments from that data.
- Key idea of this paper is that we can use theory plus some other observables to infer the behavior of consumption.
- Intuitively, given a model of individual choices of hours and consumption, a first order condition links consumption, hours and wages. If we know hours and wages we can infer consumption. But....

- Static FOC includes a bunch of stuff. For example, standard life cyle model with period utility function $u(c_{it}) - \phi_{it} v(h_{it})$ and complete markets gives the relationship:

$$u'(c_{it}) = \frac{\phi_{it} v'(h_{it})}{\lambda_i w_{it}}$$

- The mapping from observables into consumption depends on the model, including features of preferences, technology, policy and market structure.
  - human capital accumulation?
  - intensive/extensive margins?
  - complete vs. incomplete markets?
  - taxes and transfers?
- Compare with aggregate literature, wedges...

Understanding these issues, this paper takes a first step toward measuring consumption dispersion without using data on consumption.

- Issue 1: they show that panel data on hours and wages is sufficient.
- Issue 2: they adopt a simple benchmark model that includes taxes but allow the data to tell them how much insurance is offered in the market. [Think of complete markets and Pijoan-Mas (2006) as bracketing the data.]Strong assumptions on the nature of shocks.
- Issue 3: they assume their model is correct. But, because there is consumption data for part of the sample period, they can compare their inferred series with the actual series for the period of overlap.

Additional Comments

- Transparency is a virtue, but general method is potentially applicable in much richer settings.
- Where does the insurance come from?
- How to think about initial conditions?
- Efficiency
- Assets