Redistributive Taxation and Personal Bankruptcy in US States

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What the paper does

- Exploit state variation on the tax and transfer system and on bankruptcy regulation to study how the variance of consumption growth is affected by these policies.
- Main Hypothesis: Both policies are imperfect substitutes in providing consumption insurance.

The Approach

- Paper uses data for 18 US States over the period 1980-2002 to measure the variation across states on:
  - bankruptcy exemptions (new measure).
  - the redistribution through the tax and transfer system (combine CPS data with TAXSIM program).
  - cross-sectional variation on consumption measured by the standard deviation and variation in growth rates (use CEX data)

The Approach (2)

- Estimate three set of equations with different dependent variables but similar controls:
  - Regress household unsecured debt on household characteristics, bankruptcy exemptions, and redistribution measure.
  - Regress the measures of consumption variation (within state-year cells) on policy variables (exemptions and redistribution through tax-transfer system.
  - Investigate the correlation between the two policy variables across states.

Redistribution through Taxes and Transfers

- Mean marginal tax rates
- Income compression:

$$1 - \frac{sd_{st}(income_{ist} - taxliability_{ist} + transfers_{ist})}{sd_{st}(income_{ist})}$$

Proxy for consumption insurance for each state and year

For each state-year cell, compute across households the following statistics:

- Standard deviation of consumption.
- Standard deviation of changes in consumption growth.

Ideally, one would like to measure the response of individual consumption to labor income shocks AND to distinguish between temporary and permanent shocks.

Regress Unsecured Debt

Regressors: Measures of taxes/transfer and bankruptcy exemptions plus standard controls on household characteristics and time/state dummies. The estimates imply that the effect of:

- redistribution through taxes and transfers is insignificant.
- bankruptcy exemption for renters is negative but insignificant.
- bankruptcy exemption for homeowners is positive.

Comments:

- No evidence that two policy instruments have opposite effects on unsecured credit.
- Question: What are the effects on secured credit?

Regress Household Consumption Insurance

$$y_{st} = \beta_0 + \beta_1 \tau_{st} + \beta_2 x_{1st} + f_s + \varepsilon_{st}$$

- y_{st} measure of household consumption insurance in state s and year t,
- τ_{st} measures redistribution through the tax-transfer system,
- x_{1st} is the bankruptcy exemption,
- f_s state fixed effect.

State fixed effect $\Rightarrow$Identification comes from time variation within states.

Estimation and Interpretation of results are tricky

1. No ”clean” measure of consumption insurance.
    - Need to estimate consumption response to income shocks. [More]
    - Theory implies that response varies depending on whether shocks are temporary or persistent. [More]
2. Evidence that wage process has changed over time in the US (Heathcote, Storesletten, and Violante (2008)). State fixed effects may not be enough.
3. Endogeneity of regressors. [More]
4. What about durable consumption and secure debt?
5. Any insurance beyond direct redistribution?

Empirical Evidence on Housing Collateral and Risk Sharing

Lustig and Van Niewwerburgh (2005):

- Construct measures of consumption and income data for US metropolitan areas.
- Show that degree of risk sharing varies with the housing collateral ratio.
- Similar evidece for Canadian provinces and UK regions.

There is also evidence of positive correlation between labor market and housing markets (Ortalo-Magne and Rady (1998), Krueger and Perri (2009)).

Concluding Remarks

- Paper addresses an important question.
- Paper finds suggestive evidence that social insurance policies may be imperfect substitutes in insuring consumption.
- Data limitations and complex channels through which social policies affect risk sharing, underscore the importance of building a quantitative theory for assessing welfare effects of social insurance policies.

Literature on Consumption Insurance

Dynarski and Gruber (1997), Krueger and Perri (2004), among others:

$$\triangle logc_{it} = \alpha_1 + \alpha_2 \triangle logy_{it} + \alpha_3 timedummies + \beta X_{it} + \varepsilon_{it}$$

Suggestion: Why not add an interaction term (changes on income and redistribution variable) to standard consumption growth equation? (similar to what Lustig and Van Niewuwerburgh did to analzye the effects of housing collateral on risk sharing). [Back]

Recent Literature on Consumption Insurance

Blundell, Pistaferri, and Preston (2008) and Kaplan and Violante (2008) define the insurance coefficient for shock x_{it}:

$$\phi^x = 1 - \frac{cov(\triangle logc_{it}, x_{it})}{var(x_{it})}$$

Shocks x_{it} are not observed but (under some assumptions on labor income process) BPP propose a strategy to identify and estimate the insurance coefficients. [Back]

Instruments for Redistribution Policies (not for exemption levels)

- Lagged values of redistribution measures.
- Instruments contatining political variables (such as affiliation of the state governor).

Main result that bankruptcy exemption and tax-transfer redistribution has opposite effect on consumption insurance does not hold when using political instuments (Table 7, columns 4 and 9). [Back]