

Discussion: *‘Longer-Term consequences on income distribution of the Great Recession’*

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“Incomes Across the Great Recession”

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Questions & Approach of Report: Part II+III

Main Questions:

- Part II: What are the determinants of permanent shocks to income?
- Part III: What is the long-term effect of income shocks on welfare?

Approach:

- Use as proxy for income shock self-reported 'financial hardship'
 - *Use exceptional new retrospective data source on life-time events and outcomes covering multiple European countries*
- Part II: analyze determinants of 'financial hardship' and its duration
 - *Which life events lead to hardship, how do they vary with business cycle?*
- Part III: study long-term effect of 'financial hardship' on income & consumption
 - *How does persistence depend on life-course and business cycle?*

Summary of Main Findings of Report

1st Part:

- *Permanent shocks to income are not insured, i.e., they affect consumption*

2nd Part:

- *Incidence of financial hardship (FH) peaks age 20s, lasts ~7 years*
- *Individual events matter most (divorce, widowhood, unemployment)*
- *Aggregate patterns matter (e.g., recessions), but effects smaller*

3rd Part:

- *FH persistently raises food share of consumption, lowers perm. income*
- *Effect differs across countries: Nordic vs. Middle vs. Southern*

Overview of Main Comments

Comment No. 1:

- *I really like the question and approaches in both Parts II and III*

Comment No. 2:

- *Which income shocks does 'financial hardship' capture?*

Comment No. 3:

- *Also use other 'life events' directly to explain long-term outcomes?*

Comment No. 4:

- *May be worth to eventually broaden measures of 'welfare'*

**Comment No. 1: Understanding the Nature and Effect
of Shocks to Earnings, Income, Consumption**

Why I really liked this report:

Economists often Analyze Changes in Wages or Income :

- *Call it 'shock', but it is somewhat of a 'black box'*
- *Part II: seeks to 'explain' the incidence & distribution of such shocks*
- ***Important question and appropriate approach:***

→ *'income shock' = f(life events, macro conditions, interactions)*

When do 'shocks' lead to lasting effects on welfare?

- *Typical approach: Isolate measure of 'exog.' shock & do short-term follow-up*
- ***Part III: appropriate focus on life-time outcomes***
- *Care has to be taken how 'event' is chosen*

→ *Life-time outcomes = f(life events, macro conditions, interactions)*

Figure 5A: Annual Earnings Losses Before/After Job Displacement in \$1000
Averages for Displacements in NBER Recessions and Expansions
Men with At Least 3 Years of Job Tenure Displaced at Firms Size 50+
Displaced as Firm has Lasting 30% Employment Drop Over 2 Years

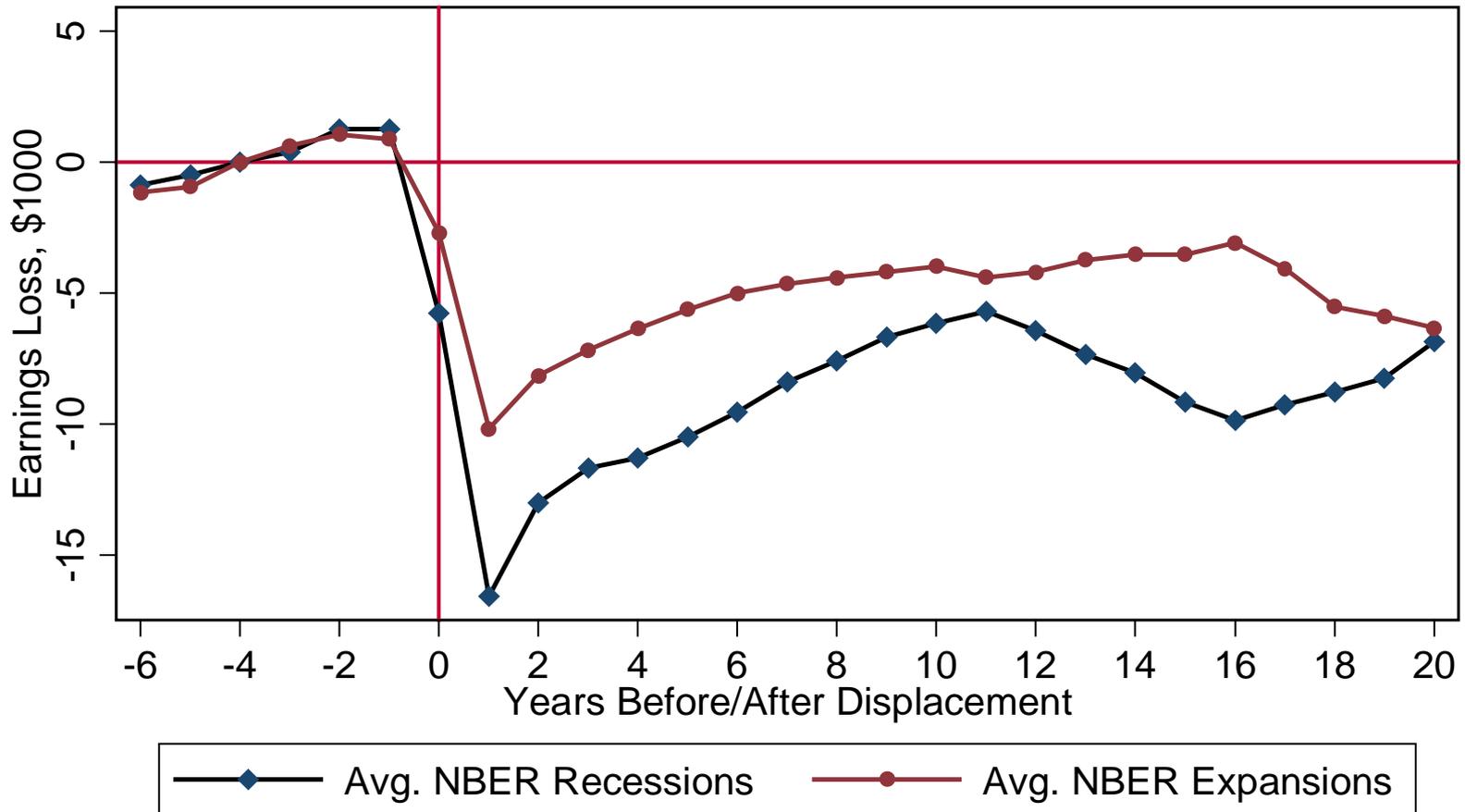


Figure 7: Present Discounted Value of Earnings Losses By Year of Displ. Expressed as Multiple of Annual Earnings Before Displacement
Men with At Least 3 Years of Job Tenure Displaced at Firms Size 50+
Displaced as Firm has Lasting 30% Employment Drop Over 2 Years

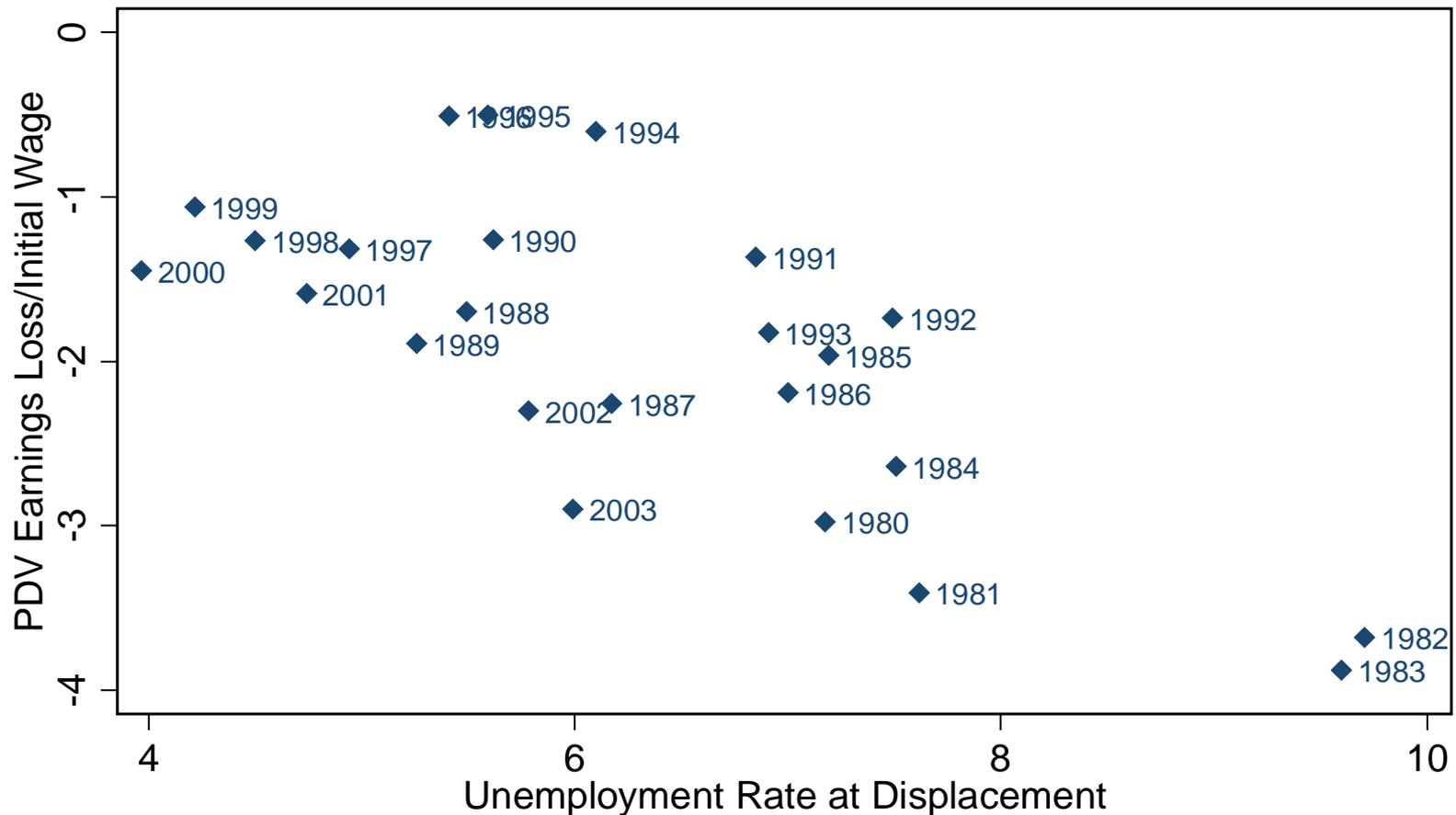
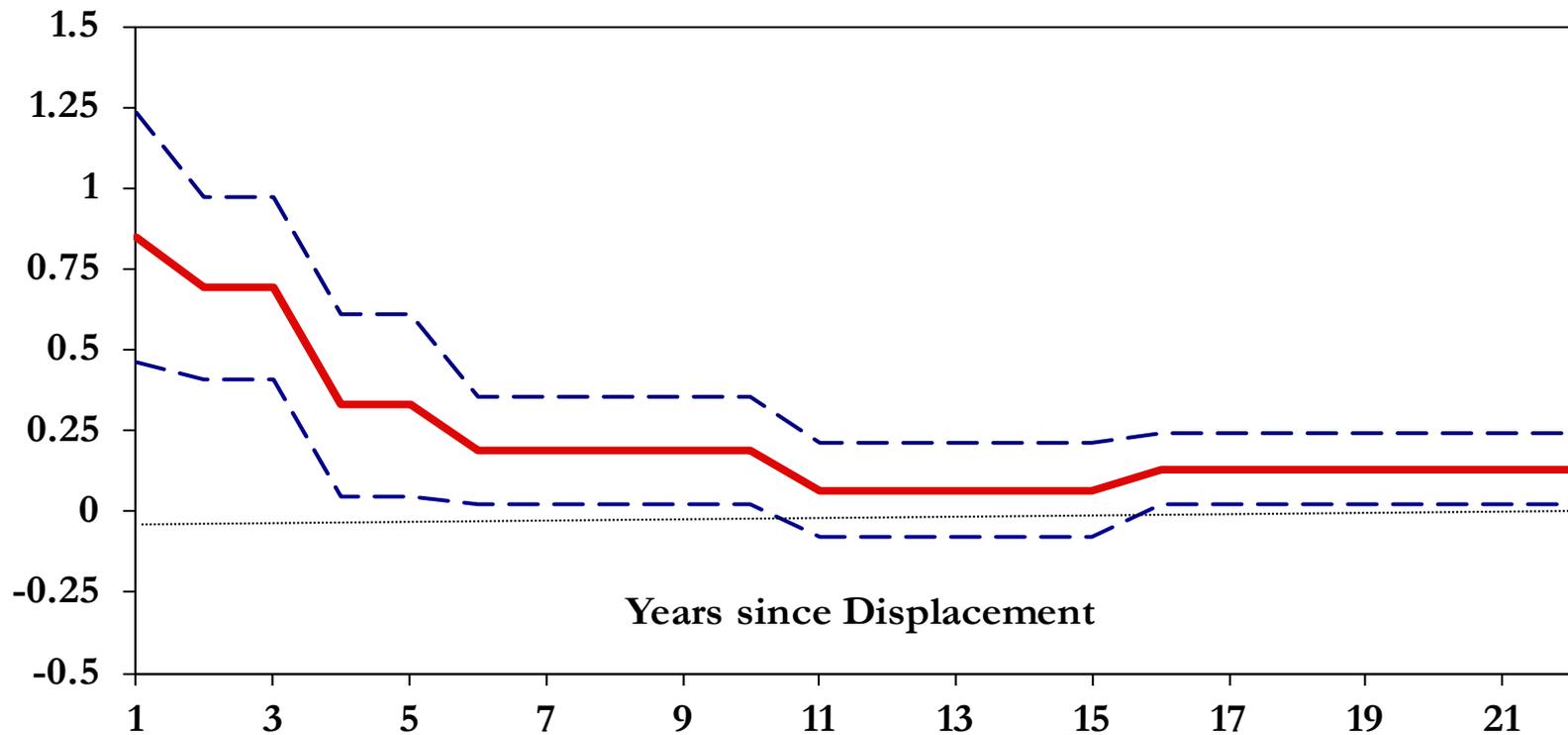


Figure II: The Effect of Displacement on Log-Odds of Death by Years Since Displacement

Panel A: Effect by Years Since Displacement for Workers Born 1930-1959
(Including Two Standard Error Bands)



Notes: Solid line represents coefficients of log-odds model of mortality on years since displacement and basic other control variables. These are the main effects corresponding to Column 1, Table 4. Dashed lines represent two-standard error bands.

Comment No. 2: Income Changes vs. 'Financial
Hardship'

Which income shocks does ‘financial hardship’ capture?

Question: Which income shocks do episodes of ‘financial hardship’ capture? Do these episodes correspond to similar ‘life events’?

- *Data Problem: typically do not have sufficient panel data to study long-term outcomes of specific shocks lying in the past for large samples of individuals*
- *Solution here: use a proxy – but what does this proxy measure?*

Potential Additional Steps to Address ‘External Validity’:

1. *Where in distribution of income shocks does ‘financial hardship’ lie?*
2. *Use ECHP to directly analyze how life events contribute to income shocks, and how this differs according to macroeconomic conditions?*
3. *Use ECHP to offer some evidence on persistence of income shocks that do not lead to financial hardship?*

More Details on Comments on Part II:

Show some basic statistics on correlation of hardship and events

→ E.g., what fraction of unemployment spells lead to hardship by cycle?

Show implied percentage effects (Table 3) by gender and age

→ Widowhood likely to mainly affect women, unemployment mainly young?

→ Unemployment may have differential effects by gender

→ Baseline probability differs, too (very low for middle aged men: 0.2%; that implies a 10-fold increase in the chance of hardship at divorce – unlikely?)

Include interaction between recession and incidence of unemployment

→ Interaction effects angle given goal of report

Try to control for age, year, cohort effects when looking at country figures

→ Impose simple functional form. Or try exclusions, such as dropping WWII

Scatterplot of coefficients from single countries vs country characteristics?

→ *Alternative way of ‘smoothing’ than grouping countries in separate regressions*

Comment No. 3: Income Changes as Underlying
'Shocks'?

Use income shock to study long-term outcomes?

Income changes & financial hardship are both outcomes:

- *Important descriptive analysis of determinants of shocks [Part II]*
- *Provide helpful evidence on autocorrelation of income shocks [Part III]*
- *Unclear whether estimates are causal, or what parameter is obtained*

Possible Additional Steps to Address ‘Internal Validity’:

- *Use early conditions to account stepwise for ‘omitted variable’ bias*
 - Exploit strength of SHARE data
- *Provide evidence on long-term effects of main life events*
 - Compare estimates of persistent effects

More Details on Comments on Part III:

1. Show effects of other life events on long-term outcomes

Unemployment during recession, bereavement, divorce

Show effects by gender, by age of event

→ **Benchmark size of effect of financial hardship**

→ **Exploit data at disposition more fully**

→ **Include some events that are exogenous or more insurable?**

2. Clarify size and time pattern of effect of financial hardship

3. Acknowledge presence of age, cohort, year effects

→ *Perhaps restrict to a subset of age and year ranges as specification check*

4. Scatterplot of coefficients from single countries against country charact.

Comment No. 4: Measures of Long-Term 'Welfare'

Worker Anxiety Rises in Recessions: Workers Care About Unemployment and Job Loss for Multiple Reasons

1. Job losers suffer large and lasting **earnings losses** over 20 years

von Wachter, Song, and Manchester (2011): United States

2. Job losers experience rise in job & earnings **instability** for 10 years

Stevens (1997), von Wachter, Song, and Manchester (2011): United States

3. Male job losers can suffer lasting rise in **mortality rates** for 20 years

Gallo et al. (2004), Sullivan and von Wachter (2009): United States

4. Unemployment and job loss lead to a **rise in divorce, decline in fertility**

Charles and Stephens (2004), del Bono, Weber, Winter-Ebmer (2011)

5. Long-term effects on **displaced workers' children**

Oreopoulos, Page, and Stevens (2008), Schaller and Stevens (2010): Canada, U.S.

➔ **SHARE data lends itself to analysis of alternative outcomes**

Conclusion: Income Shocks, Financial Hardship and Long-Term Income and Consumption

- *I really like idea to understand sources of income shocks that are typically studied [Part I]*
- *I really like the approach to study the long-term effect of adverse life events [Part II]*
- *Report does excellent job in addressing these questions using a new appropriate data source*
- **Main Comments: (1) clarify the relationship between financial hardship and typical income shocks we study (2) use retrospective data to deepen analysis of long-term effects**
- **Also worth broadening the concept of ‘welfare’ and look at other outcomes available in SHARE data source**

Conclusion (Continued)

Final Comment

→ To assess impact of recessions on likelihood of financial hardship (and possibly other events), in Part II also show 'reduced form' that only includes variables relating to recessions as measures of 'events'