

Heterogeneity in MPCs Beyond Liquidity Constraints: The Role of Persistent Earnings

Jeanne Commault

Abstract :

Understanding the distribution of marginal propensities to consume (MPC) in the population is key to model the transmission of shocks and of policies to the economy. Recent empirical findings are challenging the view that this distribution is mostly explained by liquidity constraints as: (i) liquid wealth reduces the MPC but only modestly so; (ii) current earnings, which should relax the constraint, tend on the contrary to raise the MPC. I note that a mechanism explaining (i)-(ii) is present in a standard life-cycle model with a persistent earnings component: when human capital is more risky than the other forms of capital owned, an increase in the persistent component scaling the human capital strengthens precautionary behavior and raise the MPC. In survey data, I show that the persistent component of earnings correlates significantly and positively with the MPC and the effect is large enough to explain (i)-(ii). In numerical simulations, the effect remains small with a simple earnings process but matches survey estimates with a rich earnings process.