Comments on the objective
Comments on the methods of evaluating three aspects
General comments

# Comments on Kubota-Fukushige paper "Rational Consumption"

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# Objective

▶ The stated objective is to empirically test the Life-Cycle, Permanent-Income Hypothesis separating the hypothesis into three components:
  1. rational expectation
  2. planning ability
  3. execution ability

  using data collected by Osaka University.

▶ This is highly interesting objective assuming that how households behave itself is of interest or how realistic the model is is of interest.

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## Objective (continued)

- ▶ Another perspective: Ask how a model is used and examine the performance of a model relative to that use.

- ▶ Example: How well the increase in consumption is predicted using the LCPIH given an increase in temporary transfer payment.

- ▶ Whether the model itself is realistic is of secondary importance.

- ▶ How well the model does in terms of predicting the increase in consumption compared to a competitor is of primary interest.

- ▶ This perspective may help put relative weight in evaluating three aspects examined in this paper.

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## Rational Expectation

▶ Examined using the microdata on the reported expectation of the future income growth rate and the realized income growth rate (using time dummy variable and FE/RE model with IV (subjective unemployment probability):

$$GY_{i,t+1} = \alpha + \pi GYE_{i,t} + \beta YD_t + \mu_i + \epsilon_{i,t+1}$$

▶ The restriction holds over time, not across individuals.

▶ One should exploit panel data more.

▶ The $GYE_{i,t}$ is a categorical variable, so the classical measurement error model does not apply.

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## Rational Expectation (Continued)

- ▶ Without the FE/RE component, the situation can be examined using the Manski-Tamer framework.
- ▶ With the FE/RE component, a new framework needs to be developed.
- ▶ It's better to drop categories 0 and 10 and one additional one and reexamine the data.

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# Planning Ability

- A household's planning ability is classified into three categories; high, middle, low, using the answer to the question how one thinks he/she fits to the statement "I always act after making a future plan."
- Only about 21% is classified as high and 33% low.
- If something is a routine, then one does not need to always plan.
- Rational Expectation hypothesis is reexamined for each of the groups.

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## Planning Ability (Continued)

- ▶ They obtain a beautiful result that "high" group's rational expectation hypothesis is not rejected!
- ▶ An assumption is that the categories are not correlated with the random term in the prediction equation.
- ▶ This may not be, because those who do make plans may be hit with positive shocks more often.
- ▶ Some discussion would be useful.
- ▶ A panel data analysis per individual avoids a need for classification.

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## Execution Ability

- ▶ A household's execution ability is classified into three categories; high, middle, low, using the answer to the question how one thinks he/she fits to the statement "I cannot refrain from consumption."
- ▶ About 39% is classified high.
- ▶ Excess sensitivity is examined for the 9 groups (Execution × Planning).

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# Execution Ability (Continued)

- ▶ They obtain a beautiful result that "high" in both planning and execution ability group's do not have excess sensitivity to the expected income growth!
- ▶ The group is 9% of the overall population.
- ▶ The way IV is constructed is not understandable.
- ▶ The categorical variables defining the groups need to be uncorrelated with the error terms as before.

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## Comments

- ▶ Policy implication is that a large fraction of population would react to a temporary income increase.
- ▶ The reason, according to the present paper, is that a large fraction of households either do not have ability to refrain from consuming or cannot plan ahead.
- ▶ Whether this can be sustained repeatedly is questionable, however.
- ▶ This paper treats the optimization behavior as a positive model and examine its validity empirically.
- ▶ Alternatively one can view the optimization behavior as a normative model that informs us how one should behave if we want to maximize our utility.
- ▶ A question is if this no-refrain, no-planning behavior is not consistent with an optimization behavior, if a large fraction of us would keep repeating the same mistake.

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## Comments (Continued

- ▶ This is a very interesting paper that uncovered the lower bound fraction of population behaving consistently with the LCPIH theory. It would be better to write this paper in English to aim at a more general academic contribution.

- ▶ On a different note, more complete discussion of the related literature, especially those by fellow Japanese should be given.

- ▶ For example there are beautiful papers by Unayama san and Shimizutani san (and I'm sure others) on very closely related topic and also older papers by Shinohara san and Hashimoto san both in JPE using Bonus payments. There is a survey paper by McKenzie san on the topic as well.

- ▶ We should collude to cite our fellow researchers' work more!