Discussion: Hubmer et al. (2020) "Sources of US Wealth Inequality: Past, Present, and Future."

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Summary

Goal: Understand the evolution of the U.S. wealth distribution since 1960.

- rather like the time series version of Huggett (1996)

Key model features:

- progressive taxation that changes over time
- rates of return differ by wealth and across persons and over time (exogenously)
- earnings shocks change over time (rising wage inequality)
- falling labor share

Key results

The model matches wealth inequality data well.

Progressive taxation is key for rising wealth inequality.

Changing asset returns are key for matching the U shape of inequality.

Expectations are surprisingly unimportant

- do agents foresee future asset returns?

Key assumptions: Infinite horizons

Households live forever

- this is advertised as a "middle ground" but it's not
- bequests must be far too large, especially for the rich
- cannot discipline with intergenerational moments / age profiles
- this begs to be redone with a life-cycle model (e.g., stochastic aging)

Rates of return

Motivated by evidence:

- richer households hold different portfolios (hence earn higher returns)
- average return differs across households (a fixed effect)

All this is packaged into a rate of return function:

$$1 + \underline{r}_t + r_t^X(a_t) + \sigma^X(a_t)\,\eta_t \tag{1}$$

Parts:

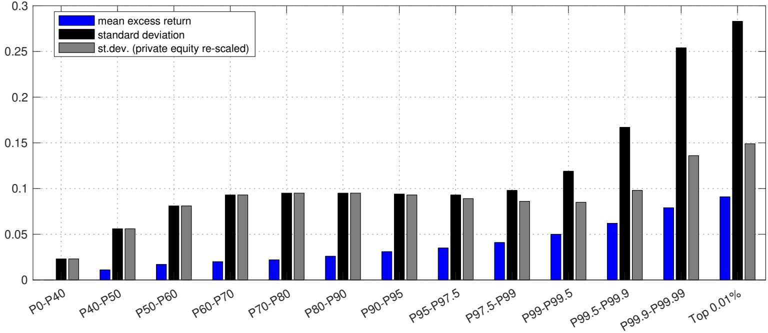
- r_t^X: time varying mean return
- η_t: idiosyncratic dispersion in returns (i.i.d.)

A reduced form - would like to open the black box.

Very clever!

Rates of return

Figure 6: Schedule of excess returns



Equilibrium

The key complication is expectations

- do agents predict future asset returns and wages?

Bracket outcomes by considering

- perfect foresight
- myopia

Now a very complex equilibrium has been reduced to a fairly simple (?) computational problem.

- start from steady state in 1967
- compute a sequence of static equilbria (so to speak) or a single perfect foresight path
- agents only choose savings in each period

Research opportunities

What does rate of return heterogeneity imply for taxing the rich?

- need a model that generates rates of return endogenously
- does this have to do with entrepreneurship?

Earnings are exogenous

- does this distort the effects of progressive taxes?

What does this kind of model imply for bequests?

- if bequests are realistic, do the conclusions change?

References I

Huggett, M., 1996. Wealth distribution in life-cycle economies. Journal of Monetary Economics 38, 469–494. doi:10.1016/S0304-3932(96)01291-3.