Discussion of “The Macroeconomic Transition to High Household Debt” by Campbell and Hercowitz

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Motivation:

There were large changes in the regulations affecting the market for residential real estate in the early 1980s. This resulted in a large change in the opportunities facing consumers.

Objective:

Assess the impact of these changes both qualitatively and quantitatively, for allocations, prices and welfare for agents who are in different places in the wealth distribution.

Setting the agenda.....

One possibility: We see some significant changes in the data along certain dimensions that we intuitively feel are connected to the observed changes in regulations, and the role of the exercise is to assess to what extent these changes are caused by the change in regulations.

Second possibility: We are carrying out an analysis to help uncover where the effects should show up, to be used as a guide in looking at the data, i.e., using theory to help develop intuition.

Key Observations that Influence the Analysis

Relative to the pre 1980 period, as of 2000 we see:

- There has been a dramatic increase in household debt
- Housing equity relative to value of housing has decreased
- Real interest rates are higher
- Wealth has become more concentrated among the upper decile of the distribution

All of the previous observations seem intuitively plausible consequences of a change in regulations that relaxed borrowing constraints on housing.

However, there are also other things which happened since 1980 that might be related:

- rapid increase in actual/expected productivity growth
- stock market boom
- increase in relative price of housing
- changes in the earnings distribution
- changes in inflation
- increased competition in financial markets
- other changes in financial markets, such as diffusion of credit cards, marketing strategies of auto producers

Different driving forces might have different effects along some dimensions.

I would have liked the authors to present a somewhat broader picture of various developments over this time period, e.g.,

- break down debt into housing, non-housing durables (i.e., autos), and unsecured (i.e., credit card)
- examine investment in different types of goods–residential real estate, commerical real estate, cars, other consumer durables, producer equipment
- compare changes for individuals in different places in the bottom 90% of the wealth distribution

I would also have liked that there was greater motivation for various model abstractions based on a broader look at the data.

Issues Regarding the Model

- infintey-lived versus overlapping generations
- renters versus owners
- what does it mean to buy a house?
- amount of heterogeneity
- partial equilibrium versus general equilibrium?

Despite these issues, it seems that the model developed can still be used to give an answer to a basic question such as:

“In the context of our model, how much of the increase in consumer debt/GDP or (housing debt/GDP or housing debt/housing value..) can be attributed to the change in regulations in the early 1980s.”

The previous issues may influence how much we are influenced by the answer, but nothing prevents the authors from at least giving us a sharp answer to this question.

Unfortunately, I think the authors make a serious tactical error in this regard.

Standard strategy for such an exercise is to calibrate the model based on pre-1980 observations (probably based on comparing the steady state of the model with pre-1980 averages), measure the changes in regulations vis-a-vis their effect on the financial market structure that consumes face, and then solve for the the new steady state (and possibly transition path to the new steady state) given the change in financial markets.

In my view there are two serious issues that compromise what the authors actually do.

1. The authors calibrate the pre and post 1980 financial structure so as to match both the amount of debt in 1980 and 2000.

2. They assume that there is an exogenous mapping between regulations and choices of consumers in the bottom 90% of wealth distribution.

Conclusion

Interesting issue, and one that is fascinating to think about given the “tools” that the profession has developed in recent years.

But while I can imagine that the effects of the changes in regulations by themselves might have had large consequences, the authors still have a ways to go to persuade me regarding the magnitude of those effects.