Living Arrangements and Labor Market Volatility of Young Workers

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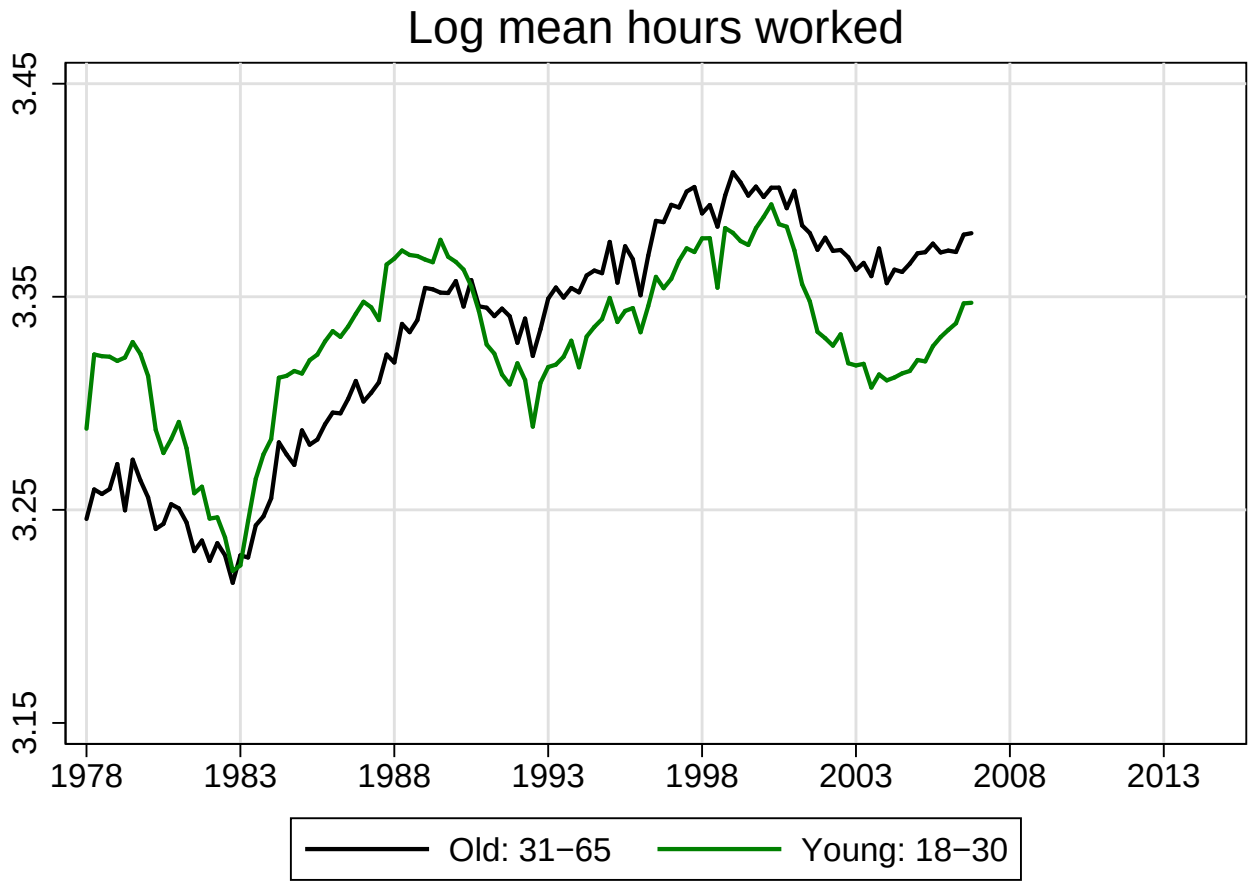
CERGE, Prague, December 9 2016

Hours fluctuations for young people



- Young people (18-30) larger cyclical volatility in "normal" cycles
- Harder hit during Great Recession

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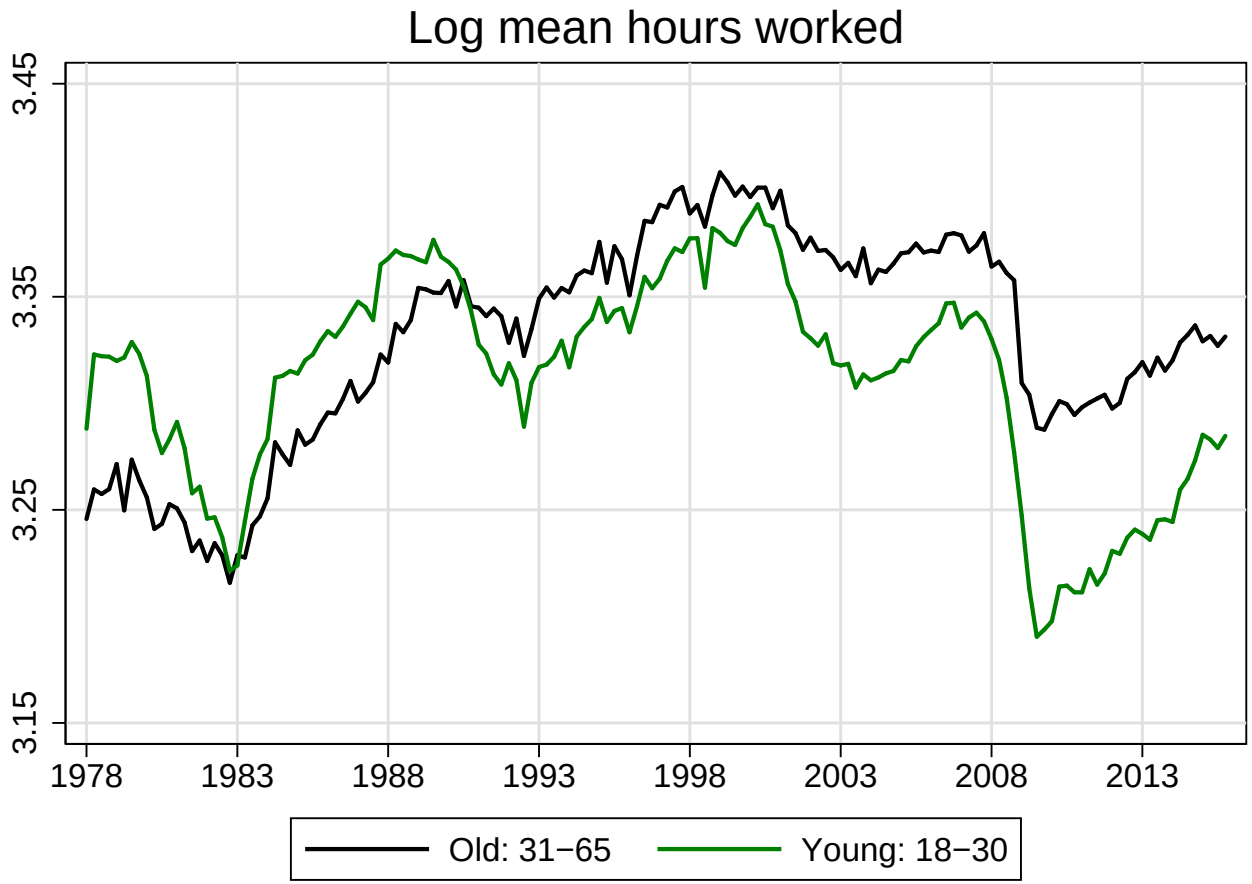

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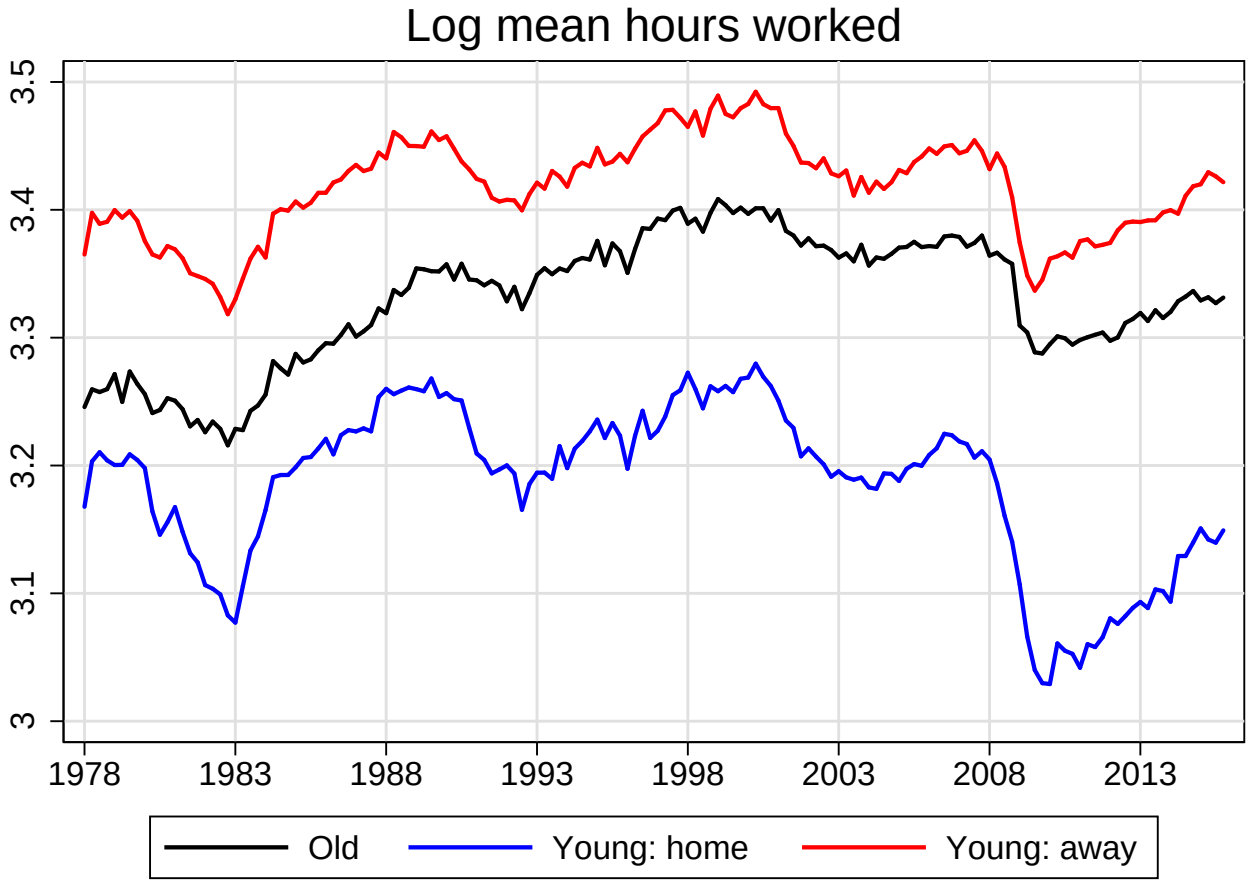
Living arrangements matter more than age



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- Young people away: higher average hours, lower volatility
- Additional volatility for young concentrated among young at home

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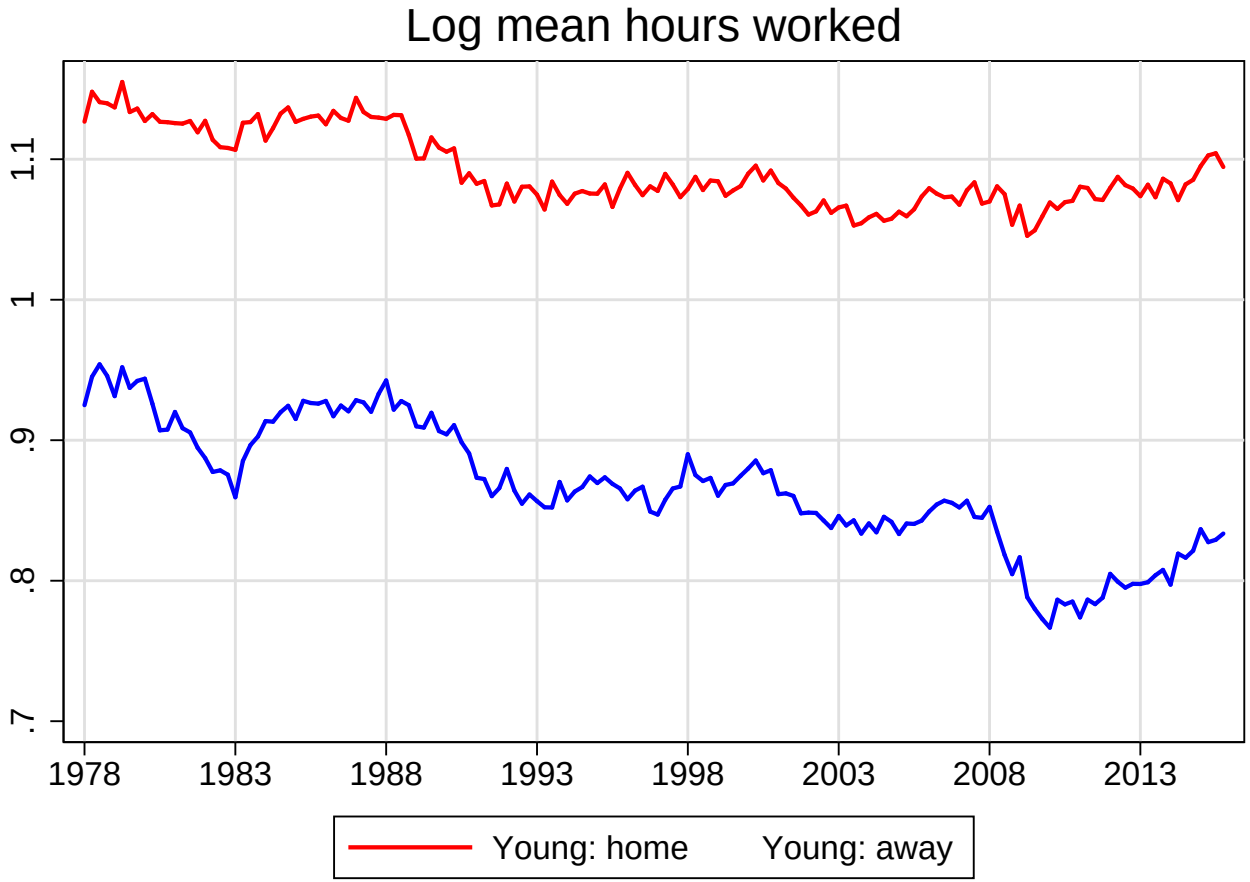

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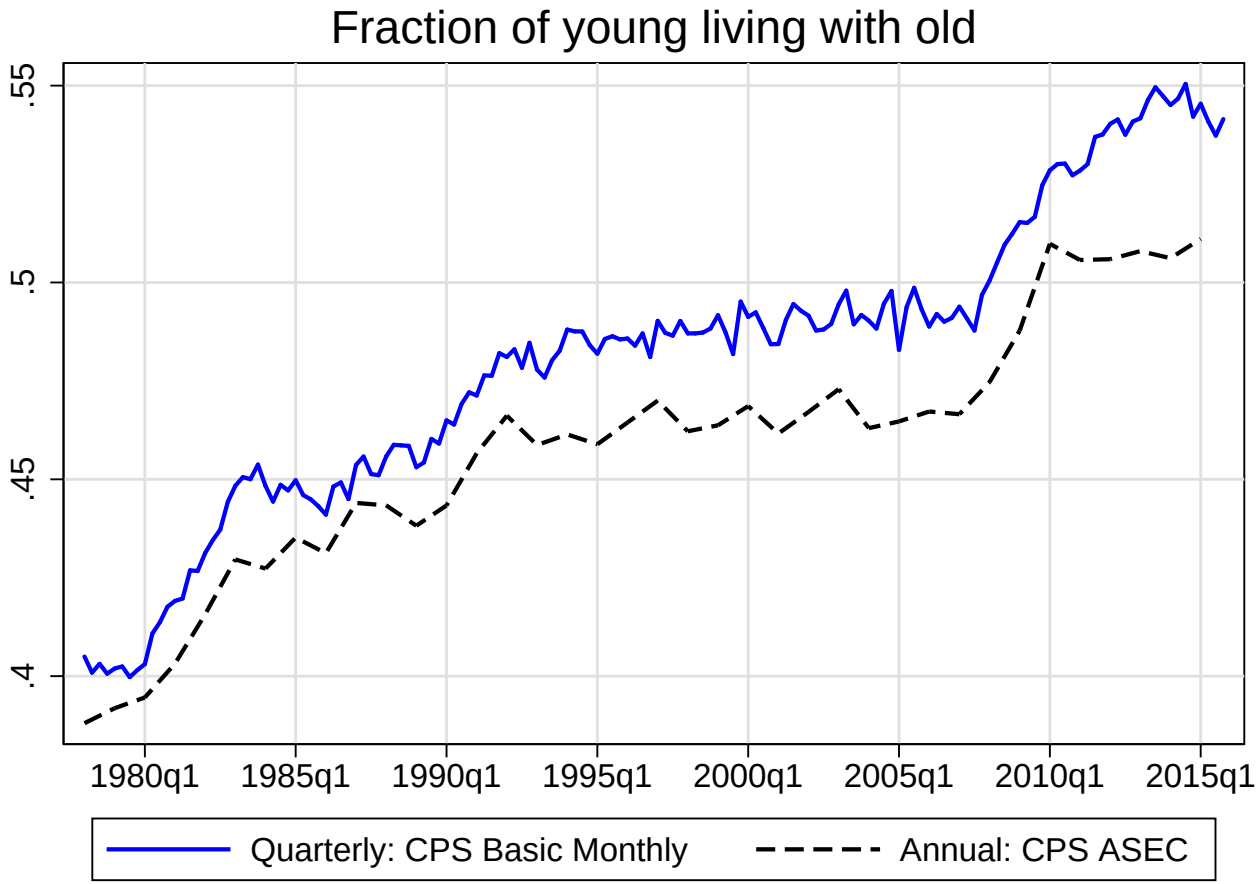
Living arrangements: endogenous, countercylical



- Increased by >5pp during Great Recession, barely fallen
- Counter-cyclical in previous cycles
- More general: hours per hh 20% less volatile than hours per person

This paper

1. Quantitative theory of fluctuations in living arrangements and hours worked for young relative to old

    - Co-residence trade-off: implicit transfers vs disutility
    - Labor supply more responsive to wages: wedge between Marshallian elasticity of young living away vs together

This paper

1. Quantitative theory of fluctuations in living arrangements and hours worked for young relative to old
2. Estimate model with aggregate data
    - Relative hours, wages by age and coresidence
    - Dynamics of living arrangements
    - De-trended from 1978 to 2006
    - Key identifying assumptions:
        a. Selection: functional forms for dist of unobservables
        b. Labor supply vs demand: conditional on skills, living arrangements do not affect productivity

This paper

1. Quantitative theory of fluctuations in living arrangements and hours worked for young relative to old
2. Estimate model with aggregate data
3. Use estimated model as measurement device
   a. Size of implicit transfers? 17% of consumption of old
   b. Difference in Marshallian elasticity by living arrangements? 60% higher for young living with old
   c. Importance of coresidence for hours of young?
      - Possibility of in coresidence: 37% of variance
      - Endogeneity in coresidence: 6% of variance
   d. Labor supply vs demand for hours volatility of young?
   e. Implications for Frisch elasticity in RA models? 85% larger

This paper

1. Quantitative theory of fluctuations in living arrangements and hours worked for young relative to old

2. Estimate model with aggregate data

3. Use estimated model as measurement device

4. Interpret Great Recession experience of young relative to old

    - Given dynamics for hours of old, were hours, wages and living arrangements of young in line with expectations based on previous recessions?
    - Additional relative shift in either labor demand or labor supply?

Logic: implicit transfers affect labor supply

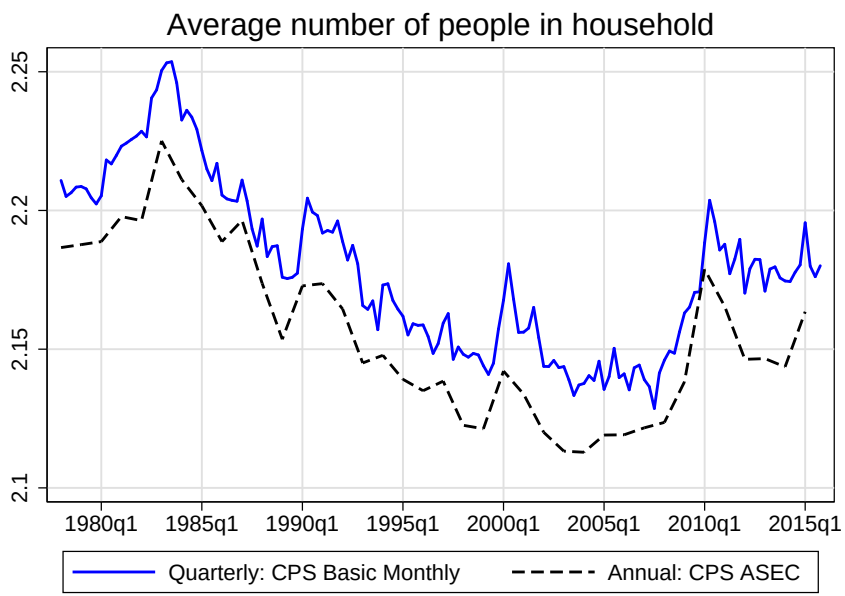
- Living arrangements matter because implicit transfers affect the Marshallian labor supply elasticity
- Young have low wealth: Marshallian more relevant than Frisch
- So young should be less volatile than old …
  …but implicit transfers and lower expenses when living with old lead to higher effective labor supply elasticity
- When labor market opportunities worsen, young people:
  - Living with parents: might as well sit on parents couch
  - Living independently: either keep working to pay the bills, like the old guys, or move in with an old guy and sit on their couch

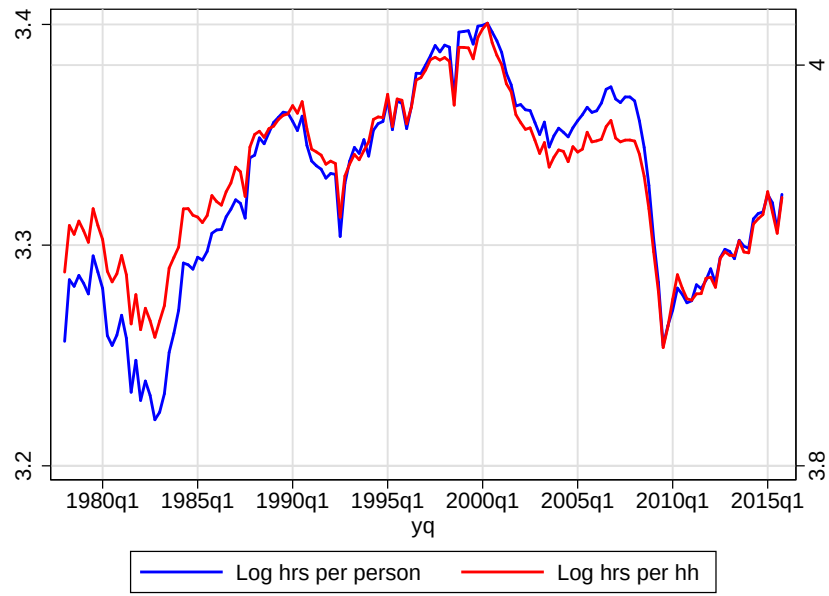
Evidence

Data: 1978-2015

- CPS Basic Monthly Surveys for hours (monthly)
- CPS ASEC for wages (annual)
- Individuals: 18-65 year olds, not in school, not in group quarters
- Households: households with at least one such person
- Household size: number of 18-65 year olds not in school
- Quarterly series: de-seasonalize using X12-ARIMA from BLS
- Detrending:
  - 1978-2006: Hodrick-Prescott and various other filters,
  - 2007-2010: Great Recession
  - 2011-2015: Great Recession recovery

Hours at the household level





- Household size moves a lot: trend and cyclical
- Hours per person more volatile than hours per household

Useful decomposition

- $H =$ total hours
- $N =$ number of individuals
- $F =$ number of households

$$\underbrace{\frac{H}{N}}_{\text{hours per person}} = \underbrace{\frac{H}{F}}_{\text{hours per household}} \div \underbrace{\frac{N}{F}}_{\text{persons per household}}$$

- Cyclical fluctuations

$$V\left(\log \frac{H}{N}\right) = \underbrace{V\left(\log \frac{H}{F}\right)}_{\text{hrs per hh}} + \underbrace{V\left(\log \frac{F}{N}\right)}_{\text{hh size}} - \underbrace{2COV\left(\log \frac{H}{F}, \log \frac{F}{N}\right)}_{\text{covariance term}}$$

Useful decomposition 1

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	Cyclical Variance, 78-06		Great Recession Change, 07-10	
	Quarterly	Annual	Quarterly	Annual
hrs per hh	85%	92%	84%	85%
hh size	5%	3%	16%	15%
covariance	10%	5%		

- Changes in household size offset around 8%-15% of changes in hours per person, at the household level

Living arrangements and hours of young, 78-06

Definitions:

- Population: 18-65 yr olds not in school
- Young: 18-30
- Old: 31-65
- Young away: no old people in household
- Young together: ≥ 1 old person in household

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Quarterly moments relative to old, 1978-06:

	Young	Young Away	Young Together
Mean hours	1.00		
St dev log hours	1.58		

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- St dev log fraction young with old ≈ 0.8
- Cyclical correlation ≈ -0.6

Useful decomposition 2

- Importance of endogeneity of coresidence: counterfactual series for hours assuming constant $x =$ fraction of young living with old

- All variation in hours is due to variation in hours of two groups:

$$\begin{aligned} M &= 1 - \frac{V\left(\log\left[\bar{x}h^{yT} + (1 - \bar{x}h^{y}A)\right]\right)}{V(\log h^{y})} \\ &\approx 5\% \end{aligned}$$

Wages: labor supply or labor demand?

- Living arrangements: labor supply different for young vs old
- Jaimovich, Pruitt, Siu (2013) wages → labor demand differences

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- Technology with imperfect substitutability between old and young
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- Technology with imperfect substitutability between old and young
- Estimate with cross-industry variation: qualitative success
- Problems with the labor demand story:
  - Qualitative argument fails with Frisch for old $< \infty$
  - Quantitative argument requires Frisch for young $= 7$, old $= \infty$
  - Wage volatility is basically the same for young at home and away

  Annual moments relative to old, 1978-06:

	Young	Young Away	Young Together
Mean wages	0.65	0.75	0.52
St dev log wages	1.07	1.18	1.11

  - Imperfect substitutability by living arrangements implausible

Model

Demographics

Old agents

- Identical
- Live in unitary households
- Can be invaded by a young agent

Young agents

- Two independent idiosyncratic shocks
  - Individual productivity ε
  - Distaste for living with old agents η
- Can invade an old households

At any point in time there are three types of agents:

1. Old: μ
2. Young alone: $(1-\mu)(1-x)$
3. Young together (with old): $(1-\mu)x$

Old agents

- Standard RA intertemporal problem

$$\begin{aligned} V^o\left(a; w^o, r\right) &= \max_{c,h,a'} u^o\left(c, h\right) + \beta E V^o\left(a'; w^{o'}, r'\right) \\ \text{s.t.} & \quad c + a' = w^o h + (1+r)a \end{aligned}$$

- Standard preferences

$$u^o\left(c, h\right) = \log c - \psi^o \frac{h^{1+\frac{1}{\nu^o}}}{1+\frac{1}{\nu^o}}$$

- Aggregate uncertainty: w^o, r

Young agents

- Young are hand-to-mouth

$$V^y(\varepsilon, \eta; w^y, c^o) = \max_{A,T}\{V^A(\varepsilon; w^y), V^T(\varepsilon, \eta; w^y, c^o)\}$$

- Young alone

$$V^A(\varepsilon; w^y) = \max_{c,h} \frac{c^{1-\gamma}}{1-\gamma} - \psi^y \frac{h^{1+\frac{1}{\nu^y}}}{1+\frac{1}{\nu^y}}$$
$$\text{s.t.} \quad c = w^y \varepsilon h$$

- Young together

$$V^T(\varepsilon, \eta; w^y, c^o) = \max_{c,h} \frac{[c+\zeta(c^o)]^{1-\gamma}}{1-\gamma} - \psi^y \frac{h^{1+\frac{1}{\nu^y}}}{1+\frac{1}{\nu^y}} - \eta$$
$$\text{s.t.} \quad c = w^y \varepsilon h$$

- Require $\gamma < 1$ for positive co-movement of wages and hours
- Implicit transfers from old (economies of scale): $\zeta(c_o)$

Technology

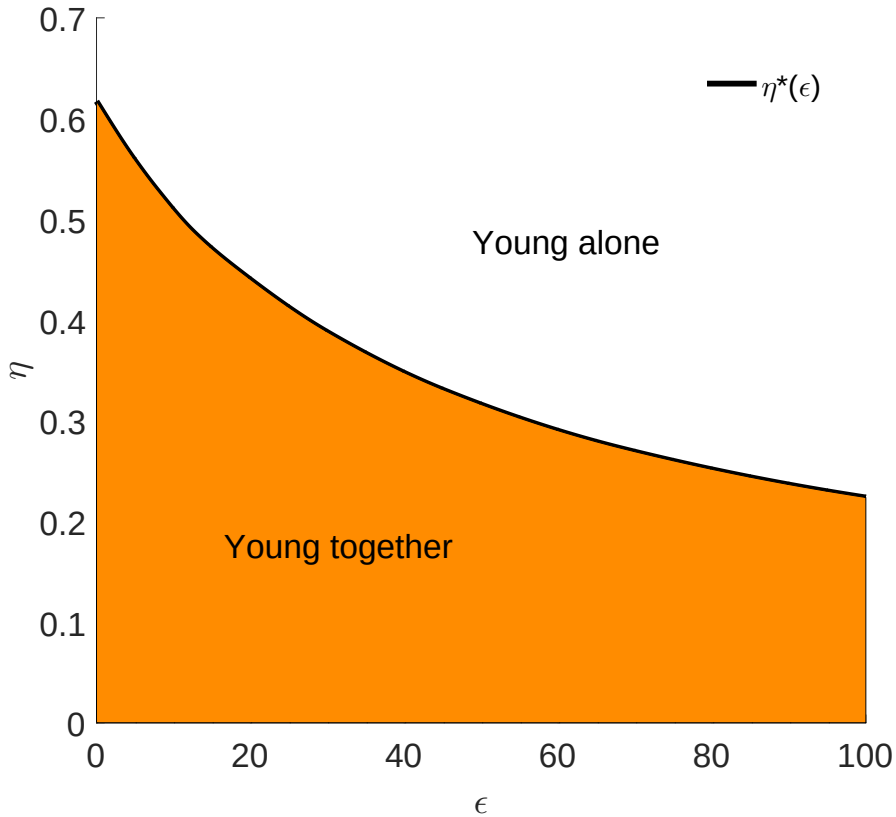
- Nested CES with capital-experience complementarity (Jaimovich-Pruitt-Siu, AER 2013)

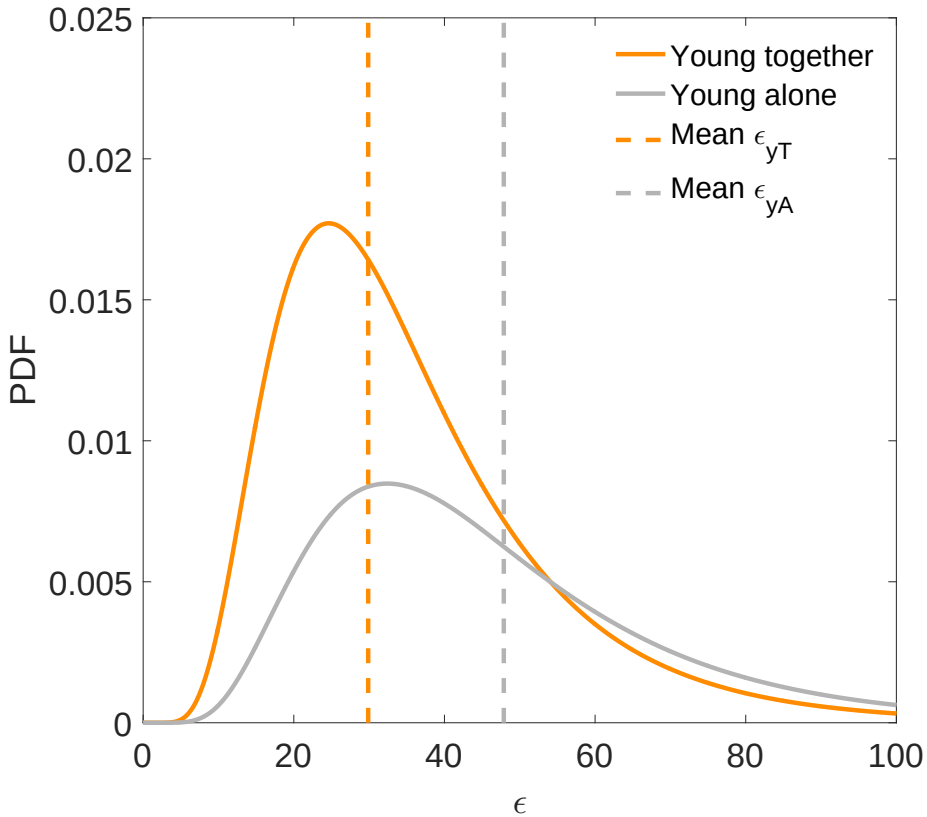
$$F(K, N^y, N^o; Z) = \left[\alpha \left(ZN^y\right)^\sigma + (1-\alpha)\left(\lambda K^\rho + (1-\lambda)\left(ZN^o\right)^\rho\right)^{\frac{\sigma}{\rho}}\right]^{\frac{1}{\sigma}}$$

  where N^y and N^o are labor inputs of young and old

- Technology generates higher hours and wage volatility for young
- Technology depends on age, but not living arrangements
- Structure on top of standard RBC model: shocks to Z

Living arrangements for young





Recursive Competitive Equilibrium

- Aggregate state of economy $s \equiv (K, Z)$
- An equilibrium is a set functions
  - consumption $\{c^{yA}(\varepsilon, s), c^{yT}(\varepsilon, \eta, s), c^{o}(s\}$
  - hours worked $\{h^{yA}(\varepsilon, s), h^{yT}(\varepsilon, \eta, s), h^{o}(s)\}$
  - threshold for staying at home $\eta^*(s, \varepsilon)$
  - fraction of young that move in with the old $x(s)$

  such that:

  - old maximize given prices
  - young maximize given prices and choice of old
  - factor markets clear
  - fraction of young living with old satisfies

$$x(s) \quad = \quad \int_0^{\infty} \int_{-\infty}^{\eta^*(s,\varepsilon)} dF_\eta \; dF_\varepsilon$$

  where $\eta^*(s, \varepsilon)$ satisfies the indifference condition for all ε.

Parameterization

Parameterization strategy

Two sets of parameters from outside model:

1. Production function elasticities: Jaimovich-Pruitt-Siu (2013)
2. Frisch elasticity of old: baseline = 0.72
   Heathcote-Storesletten-Violante (2014)

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Estimate remaining parameters using cyclical fluctuations, 1978-06

1. Standard aggregates (r, I/Y, Capital Share, Solow residual)
2. Mean hours of old, young alone, young together
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1. Standard aggregates (r, I/Y, Capital Share, Solow residual)
2. Mean hours of old, young alone, young together
3. Mean wages of young alone, young together
4. St dev hrs of young along, young together relative to st dev hrs old
5. Mean fraction of young living with old
6. St dev fraction of young living with old relative to st dev hrs old
7. Correlation between fraction of young living with old and hours

Intuition for identification

Functional form assumptions

- Productivity heterogeneity: $\varepsilon \sim \log N$
- Disutility heterogeneity: $\eta \sim N$
- Implicit transfer function: $\zeta(c^o) = \zeta_0 + \zeta_1 c^o$

10 parameters, 10 moments:

- Labor disutility old ψ^o: $E[h^o]$
- Labor disutility young ψ^y: $\frac{E[h^y]}{E[h^o]}$
- Productivity dist ε : $\frac{E[w^y]}{E[w^o]}$, $\frac{E[w^{yA}]}{E[w^{yT}]}$
- Young preferences γ, ν^y: $\frac{\sigma[h^y]}{\sigma[h^o]}$, $\frac{\sigma[h^{yA}]}{\sigma[h^{yT}]}$
- Implicit transfers ζ_0, ζ_1: $\frac{E[h^{yA}]}{E[h^{yT}]}$, $\rho(h, x)$
- Disutility dist η: $E[x]$, $\frac{\sigma[x]}{\sigma[h^o]}$

Model fit

	Data	Model
Relative hours		
$E[h^y]/E[h^o]$	1.00	1.01
$E[h^{yA}]/E[h^{yT}]$	1.24	1.34
$\sigma[h^y]/\sigma[h^o]$	1.67	1.65
$\sigma[h^{yA}]/\sigma[h^{yT}]$	0.68	0.72
Relative wages		
$E[w^y]/E[w^o]$	0.65	0.64
$E[w^{yA}]/E[w^{yT}]$	1.44	1.36
$\sigma[w^y]/\sigma[w^o]$	1.07	1.10
$\sigma[w^{yA}]/\sigma[w^{yT}]$	1.06	1.04
Living arrangements		
$\sigma[x]/\sigma[h^o]$	0.75	0.78
$corr(x,h)$	-0.56	-0.56
M	0.05	0.04
Contr F/N	0.15	0.16

Lessons

Size of implicit transfers

$$\zeta(c^o) = \zeta_0 + \zeta_1 c^o$$

1. Average fraction of consumption of old

$$E\left[\frac{\zeta(c^o)}{c^o}\right] = 17\%$$

2. Average fraction of consumption of young together

$$E\left[\frac{\zeta(c^o)}{\zeta(c^o) + c^{yT}}\right] = 50\%$$

3. Average additional hours need to work by young together

$$E\left[\frac{\hat{h}^{yT} - h^{yT}}{h^{yT}}\right] = 37\%$$

Why does coresidence affect hours?

- Frisch elasticity for old $= 0.72$
- Marshallian elasticity for young alone

$$e^{yA} = \frac{(1-\gamma)\nu^y}{1+\gamma\nu^y}$$

- Marshallian elasticity for young together

$$e^{yT}(\varepsilon) = e^{yA} \times \frac{1+\frac{1}{1-\gamma}\frac{\zeta(c^o)}{c^{yT}(\varepsilon)}}{1+\frac{1}{1+\gamma\nu^y}\frac{\zeta(c^o)}{c^{yT}(\varepsilon)}}$$

- If $\gamma < 1$, $\zeta > 0$ then $e^{yT}(\varepsilon) > e^{yA}$
- If $\zeta = 0$ then $e^{yT}(\varepsilon) = e^{yA}$. Also e^{yT} increasing in ζ

Why does coresidence affect hours?

- Frisch elasticity for old $= 0.72$
- Marshallian elasticity for young alone

$$e^{yA} \quad = 0.45$$

- Marshallian elasticity for young together

$$E\left[e^{yT}\right] \quad = 0.73$$

- If $\gamma < 1$, $\zeta > 0$ then $e^{yT}(\varepsilon) > e^{yA}$
- If $\zeta = 0$ then $e^{yT}(\varepsilon) = e^{yA}$. Also e^{yT} increasing in ζ

Importance of coresidence for hours volatility

Experiment 1:

- Possibility of coresidence, no endogeneity of coresidence
- $x = \bar{x}$: fix thresholds $\eta^*(\varepsilon, s) = \eta^*(\varepsilon, \bar{s})$
- St dev of log total hours: 5.5% lower
- St dev of log of young: 6.4% lower

Experiment 2:

- No possibility of coresidence
- $x = 0$: all young live alone
- St dev of log total hours: 31.4% lower
- St dev of log of young: 37.2% lower

Demand vs. supply channel

	Data	RBC + Imp. Subst.	RBC + Liv. Arr.	Baseline Model
Relative hours				
$E[h^y]/E[h^o]$	1.00	1.01	0.99	1.01
$E[h^{yA}]/E[h^{yT}]$	1.24	-	1.32	1.34
$\sigma[h^y]/\sigma[h^o]$	1.67	1.66	1.66	1.65
$\sigma[h^{yA}]/\sigma[h^{yT}]$	0.68	-	0.70	0.72
Relative wages				
$E[w^y]/E[w^o]$	0.65	0.87	0.66	0.64
$E[w^{yA}]/E[w^{yT}]$	1.44	-	1.37	1.36
$\sigma[w^y]/\sigma[w^o]$	1.07	1.32	1.00	1.10
$\sigma[w^{yA}]/\sigma[w^{yT}]$	1.06	-	1.00	1.04
Living arrangements				
$\sigma[x]/\sigma[h^o]$	0.75	-	0.77	0.78
$corr(x, h)$	-0.56	-	-0.56	-0.56
M	0.05	-	0.06	0.04

Implications for RA Frisch elasticity

- RA models: Frisch elasticity key for volatility of aggregate hours → useful metric for measuring strength of other channels

- What Frisch elasticity would RA model require to generate same volatility of hours as model with young people and coresidence?

Frisch elasticity for old (ν^o)	Implied Frisch in RA RBC model	Proportional Increase
0.72	1.33	85%
0.5	0.87	75%
1.0	2.15	115%
2.0	9.62	381%

Great Recession

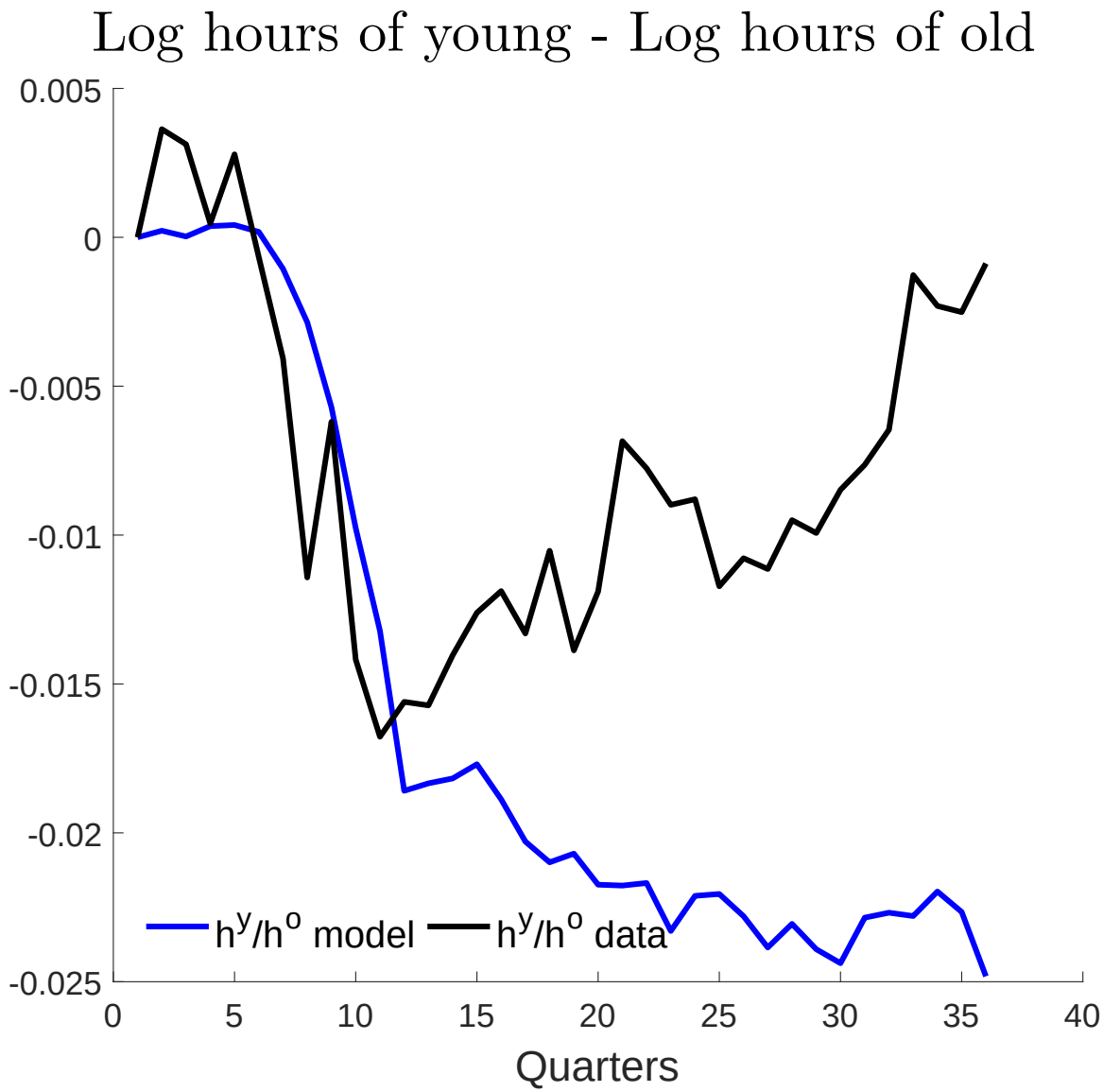
The experiment

- Look through the lens of the model at the relative (to the hours of the old) volatility of hours of young and living arrangements during the Great Recession.

- Back out the values of the shock, so that once plugged into the model it matches the mean hours worked between q1:2007 and q4:2015.

- Simulate the model forward with the implied shock values. Agents still have rational expectations about the shock realizations.

Interpreting 2007-15 dynamics



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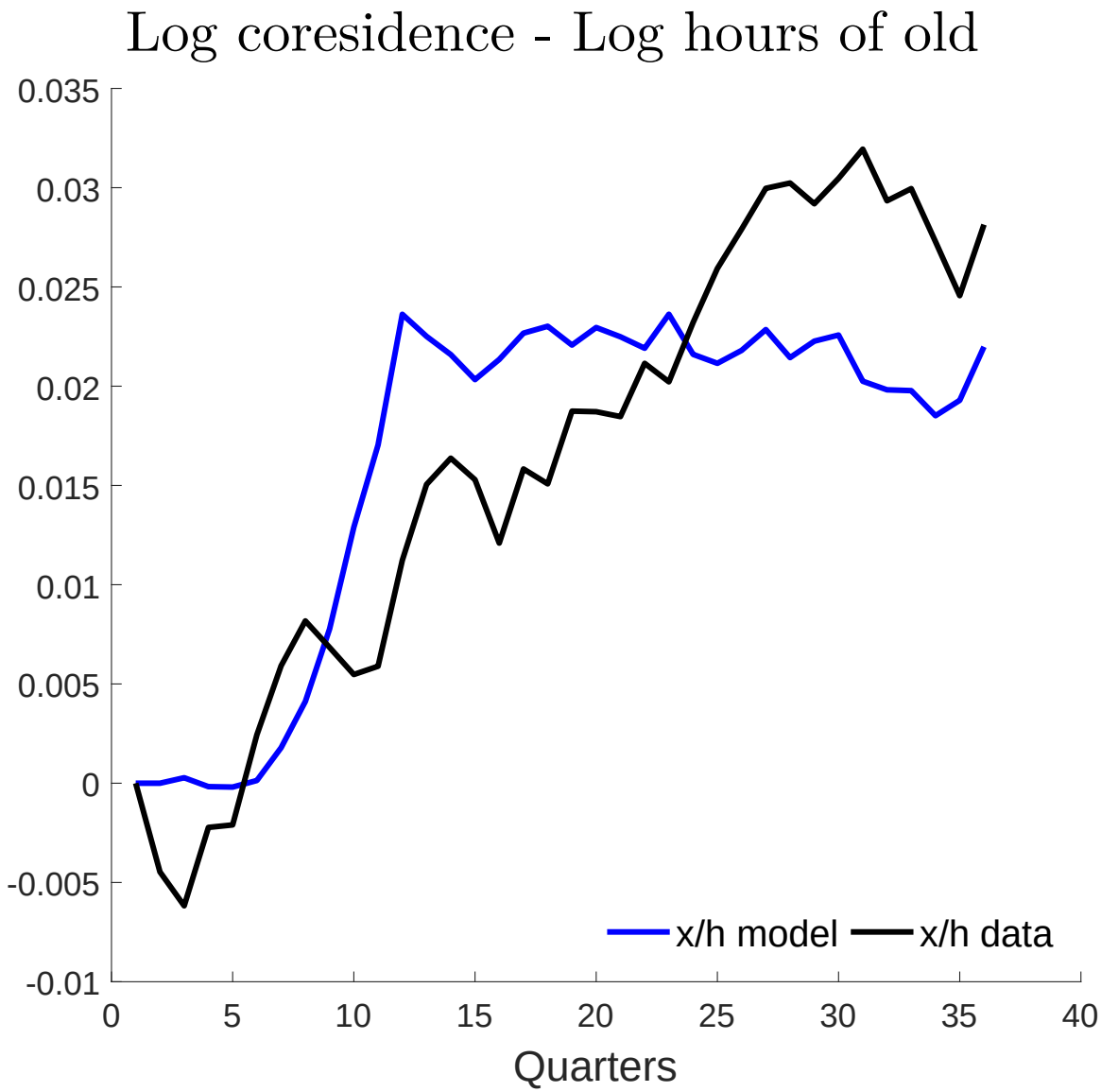

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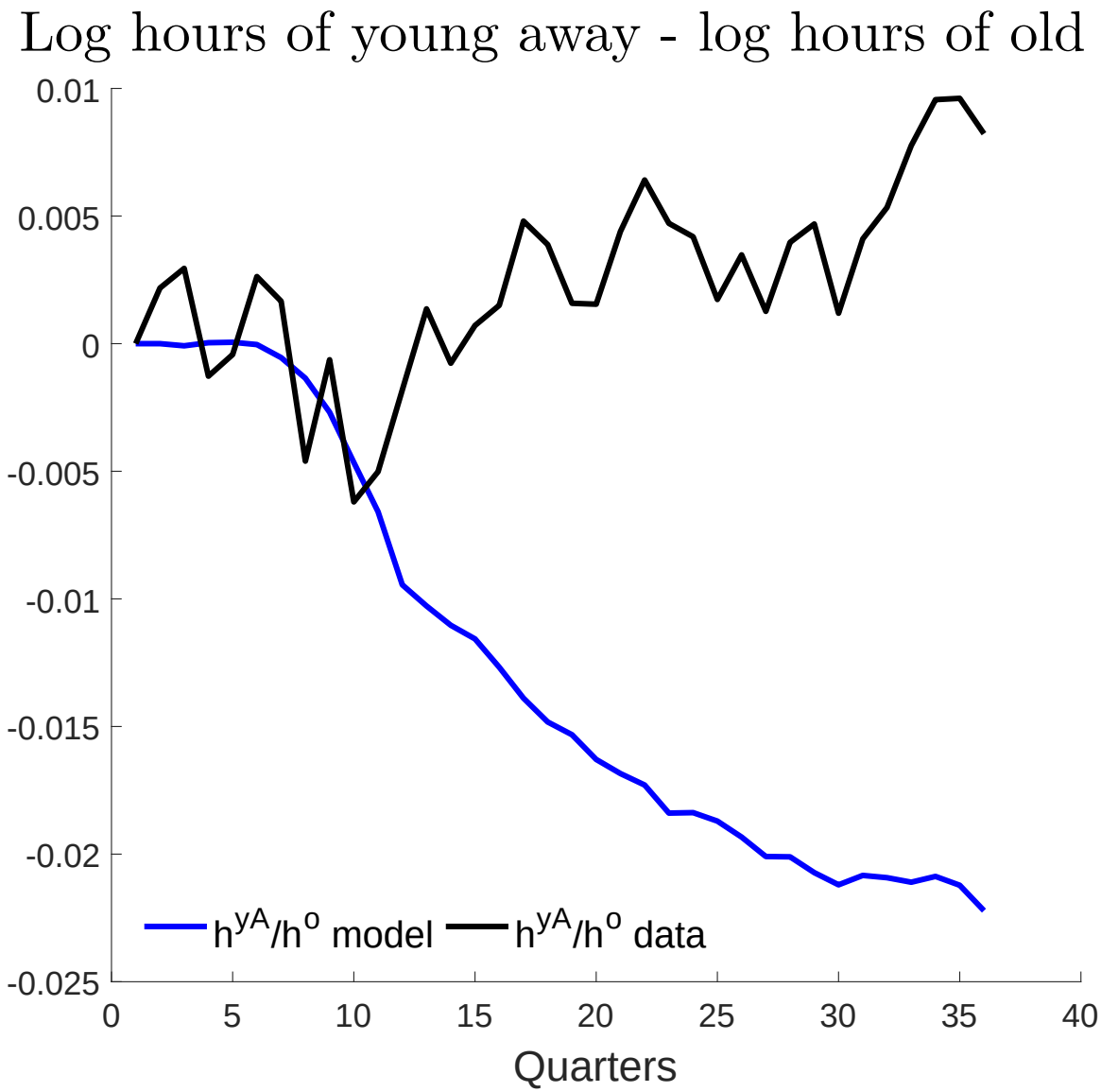
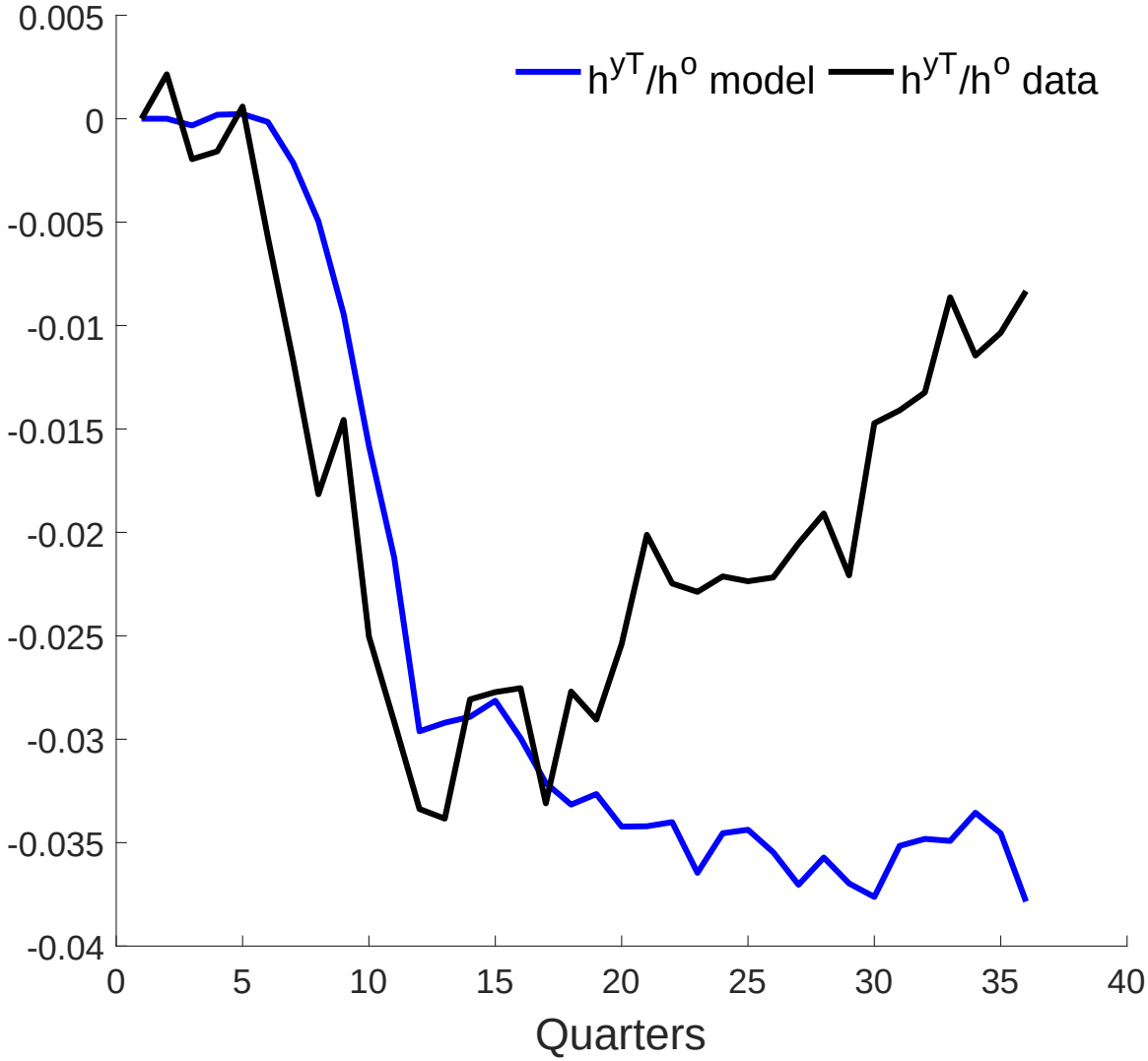


Interpreting 2007-15 dynamics

Log hours of young together - log hours of old



Conclusions

- Young and old have different labor market behaviors.
- We have documented the central role of the living arrangement in shaping the behavior of the young.
- We have also documented the cyclical movements of the living arrangements.
- We have provided a theory of how it works and mapped it to the data. This theory accounts for the average and cyclical behavior of the young and the old.
- As a bonus we have provided a logical theory of the differences between the micro and the macro (which is 85% larger) Frisch elasticities.