Testing the Permanent Income Hypothesis

The following are some questions for you to consider as you go through the required reading material which should help to guide the discussion.

- How should an exogenous increase in an individual's credit card limit affect individual borrowing if Permanent Income Hypothesis (PIH) holds?
- Consider the 2-period model of consumption and saving presented in class. Assume that individuals face an exogenous limit to borrow in period 1. Show how an exogenous increase in this limit would affect consumption and saving. Does the effect depend on whether an individual is a borrower or a lender?
- Why is it problematic to identify individuals that face liquidity constraints according to their net worth?
- Explain why ``timing rules'' that increase an individual's credit card limit automatically help Gross and Souleles to identify the causal effect of an increase in credit card limits on an individual's debt?
- Do the results in Table II lend support for the PIH?
- How does Hsieh (2003) take advantage of the Alaska Permanent Fund to test the PIH?
- Describe the estimating equation: what are the dependent and independent variables? What are the sources of variation?
- Does Hsieh find support for the PIH? Does he test the same implications as Gross and Souleles (2002)?

References

- Gross, D. B. and N. S. Souleles (2002) “Do Liquidity Constraints and Interest Rates Matter for Consumer Behavior? Evidence from Credit Card Data,” *Quarterly Journal of Economics* 117: 149-185.
- Hsieh, C.-T. (2003) “Do Consumers React to Anticipated Income Shocks? Evidence from the Alaska Permanent Fund,” *American Economic Review* 93: 397-405