



Promoting research on retirement and Social Security policy

Research Brief 320 | June 2015

Liquidity Constraints, the Extended Family, and Consumption

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The recent economic downturn has refocused attention on the role of the family in providing protection against economic shocks. The media are replete with stories of older parents helping adult children cope with unemployment, perhaps to the detriment of their own retirement and savings plans. This assistance is not limited to transfers from parents to adult children, but can also flow from children to parents, a potentially important phenomenon as layoffs in the last recession hit older workers particularly hard. Assistance can take many forms, including cash, in-kind gifts, and time help. Furthermore, even if assistance is not received, knowing that the extended family is available if needed may affect behavior.

As the national population ages and programs such as Social Security come under increasing financial pressure, understanding the role of families in providing support for their members becomes increasingly important. Furthermore, to the extent that support of adult children affects the savings and labor-market behavior of older workers, older parents may find their own futures negatively affected by shocks to the incomes of their children. And children hit hard in their peak earning years may be unable to provide for elderly parents.

Despite widespread anecdotal evidence of beneficence, empirical tests have rejected altruism as motivating intrafamily behavior. Many of these tests have relied on the relationship between changes in incomes of parents and children and changes in family transfers. However, economic models also suggest that individuals save in order to smooth consumption and cope with declines in income. A negative shock need not necessitate assistance from family if individuals have their own wealth holdings or have access to credit.

A more rigorous test of altruism would be based on changes in consumption. However, because of the paucity of consumption data in national surveys, studies examining the role of family in smoothing consumption are rare. We take advantage of the fact that the Panel Study of Income Dynamics significantly expanded the

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measurement of consumption beginning in 1999, allowing us to study a nearly comprehensive measure of consumption. Having more expansive data on consumption is important because the effects of (own) income on food consumption, which has been examined in prior studies, are small relative to the effects on other components of consumption. Therefore, conclusions that the income of the extended family has limited effects on food consumption may not characterize effects on total consumption.

Our estimates using comprehensive information on consumption imply rejection of the strict altruism model. However, the estimates also suggest evidence in favor of effects of income of the extended family on own consumption.

A distinct yet related literature concludes that consumers facing liquidity constraints spend a greater share of their transitory income relative to other consumers. These findings have important ramifications for public policy because policies that increase (or decrease) family income would have a larger effect on the macro economy if consumers facing liquidity constraints were the ones who experienced increases in their income. We build on this literature by testing whether the response of own consumption to changes in transitory income is dependent on not only one's own wealth, but the wealth of the extended family. We find some evidence indicating that the effect of transitory income on consumption is influenced by the level of wealth held by extended family members.

In sum, little to no evidence is found in support of altruism among related households. However, extended family connections do influence consumption. In particular, some evidence indicates that income of extended family members affects one's own consumption, and the effect of transitory fluctuations in own income on own consumption are contingent on the wealth of the extended family.

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Sponsor Information: The research reported herein was performed pursuant to a grant from the U.S. Social Security Administration (SSA) through the Michigan Retirement Research Center (MRRC). The findings and conclusions expressed are solely those of the author(s) and do not represent the views of SSA, any agency of the federal government, or the MRRC.

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