
Discussion of
Labor Market Experiences and Portfolio Choice:
Evidence from the Finnish Great Depression

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January 2014

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Discussion of Labor Market Experiences

Past labor market experiences and portfolio choice

- Big effect of unemployment experience (in region-sector-occupation cell) on stock market participation 15 years later
- Main result carefully documented and clearly economically significant
- Omitted variable stories (non-random selection into unemployment conditional on observables) do not seem plausible
- But channel through which the effect works is still an open question, to some extent

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Discussion of Labor Market Experiences

Past labor market experiences and portfolio choice: Channels

- Risk preferences
- Beliefs
 - pessimism about macroeconomy?
 - beliefs about (disaster) covariance of labor income/unemployment shocks and the stock market (overemphasis on salient own experience)?
 - lack of trust in stock market and financial intermediaries (Guiso et al. 2008)?
- Wealth/income risk
- Wealth/assets/income levels
 - well established channel for stock market participation effects (e.g. participation cost models)

Decomposition into wealth/income effects and residual effects

Results suggest a big part of the labor market effect is explained by unemployment → assets/income → stock market participation channel

Dependent variable Specification	Stock market participation							
	1		2		3		4	
	Point estimate	Share of total effect	Point estimate	Share of total effect	Point estimate	Share of total effect	Point estimate	Share of total effect
Income	-0.068 (-3.40)	10.0% [2.9%]	-0.065 (-4.42)	10.5% [3.2%]	-0.058 (-3.73)	8.6% [2.4%]	-0.053 (-4.00)	8.5% [2.9%]
Unemployment	-0.016 (-2.33)	2.3% [1.3%]	-0.015 (-2.09)	2.4% [1.5%]	-0.007 (-2.12)	1.1% [0.6%]	-0.006 (-1.86)	1.0% [0.7%]
Assets	-0.372 (-4.88)	55.0% [13.8%]	-0.288 (-4.70)	46.7% [15%]	-0.379 (-5.16)	56.1% [13.2%]	-0.292 (-4.72)	47.3% [15.2%]
Liabilities	0.017 (0.84)	-2.5% [3.3%]	0.016 (0.96)	-2.6% [3.6%]	0.017 (0.89)	-2.5% [3%]	0.016 (0.93)	-2.6% [3.6%]
Total	-0.439 (-5.45)	64.8% [15.6%]	-0.351 (-5.14)	56.9% [16.6%]	-0.428 (-5.69)	63.2% [14.1%]	-0.335 (-5.06)	54.2% [16.2%]

Decomposition into wealth/income effects and residual effects

- Assume structural model, with wealth w and variable of interest x , both uncorrelated with ε ,

$$y = bw + cx + \varepsilon \quad (1)$$

where $\text{Cov}(w, x) = \rho$ and $\text{Var}(x) = 1$, $\text{Var}(w) = 1$.

- Main regression in the paper

$$y = \beta x + e \quad \text{i.e.,} \quad \beta = b\rho + c \quad (2)$$

- Share of effect of x in (2) that comes through w

$$\theta = 1 - \frac{c}{\beta} \quad (3)$$

- One could easily get θ from estimating (1) and (2), but paper does something different.

Decomposition into wealth/income effects and residual effects

- Decomposition regressions

$$y = \delta w + u \quad \text{i.e.,} \quad \delta = b + c\rho \quad (4)$$

$$w = \tau x + v \quad \text{i.e.,} \quad \tau = \rho \quad (5)$$

- Measure of wealth effect share in the paper

$$\omega = \frac{\delta\tau}{\beta} = \rho \frac{b + c\rho}{b\rho + c} \quad (6)$$

- Consider some special cases
 - Entirely a wealth channel effect, $c = 0$: $\omega = 1$ and $\theta = 1$. OK.
 - No wealth channel effect, $b = 0$: $\omega = \rho^2$ but $\theta = 0$
- Thus, current decomposition method overstates wealth/income channel effect. Why not just run regression (1)?

Additional concerns about decomposition

- But also some concerns that wealth effects could be under-estimated:
 - Not just current but also lagged wealth matters in participation cost models with fixed participation costs
 - Functional form: Not necessarily linear in level of wealth
- (As the authors recognize) asset accumulation is not exogenous with regards to participation. Difficult to address. Alternative tests, methods?

Alternative test: Look at portfolio choice variables for which wealth effects are less important

- Conditional on participation, wealth effects are generally much weaker for risky asset share
- Do past labor market experiences affect risky assets share?
 - Perhaps even more detailed measures of riskiness: Compute volatility, beta of portfolio?
- If so, this would support idea that labor market experiences affect portfolio choice through channels other than wealth/income.

A few (half-baked) ideas on how to dig deeper on the channels

- Trust: Financial market participation vs. stock market participation
- Macroeconomic pessimism: Higher (precautionary) savings?
- Beliefs about labor income-stock market covariance: Portfolio composition shifted towards assets that are safer w.r.t. labor income risk?

Summary

- Basic finding on correlation between labor market experiences and stock market participation is clear and strong
- More work needed to establish to what extent the effect of labor market experiences is “just” a wealth/income effect
- Potential to enhance contribution of paper by taking broader perspective on portfolio choice and savings decisions