Living Arrangements and Labor Market Volatility of Young Workers

Sebastian Dyrda
Greg Kaplan
José-Víctor Ríos-Rull

Macroeconomics and Survey Data
Munich, December 9 2017
Hours fluctuations for young people

- Young people (18-30) larger cyclical volatility in “normal” cycles
- Harder hit during Great Recession
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- Harder hit during Great Recession
Living arrangements matter more than age

- Roughly half of 18-30 live with a 31-65 (home), half don’t (away)
- Young people away: higher average hours, lower volatility
- Additional volatility for young concentrated among young at home
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- Additional volatility for young concentrated among young at home
Living arrangements: endogenous, countercyclical

- Secular upward trend since 1980
- Increased by >5pp during Great Recession, barely fallen
Living arrangements: endogenous, countercyclical

- Counter-cyclical also pre Great Recession
- 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?
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

- $H = \text{total hours}$
- $N = \text{number of individuals}$
- $F = \text{number of households}$

\[
\frac{H}{N} = \frac{H}{F} \div \frac{N}{F}
\]

hours per person \hspace{1cm} hours per household \hspace{1cm} persons per household

- Cyclical fluctuations

\[
V\left(\log \frac{H}{N}\right) = V\left(\log \frac{H}{F}\right) + V\left(\log \frac{F}{N}\right) - 2COV\left(\log \frac{H}{F}, \log \frac{F}{N}\right)
\]

hrs per hh \hspace{1cm} hh size \hspace{1cm} covariance term
Useful decomposition

\[ V\left(\log \frac{H}{N}\right) = V\left(\log \frac{H}{F}\right) + V\left(\log \frac{F}{N}\right) - 2COV\left(\log \frac{H}{F}, \log \frac{F}{N}\right) \]

\underline{hrs per hh} \quad \underline{hh size} \quad \underline{covariance term}

<table>
<thead>
<tr>
<th></th>
<th>Cyclical Variance, 78-06</th>
<th>Great Recession Change, 07-10</th>
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<tbody>
<tr>
<td></td>
<td>Quarterly</td>
<td>Annual</td>
</tr>
<tr>
<td>hrs per hh</td>
<td>85%</td>
<td>92%</td>
</tr>
<tr>
<td>hh size</td>
<td>5%</td>
<td>3%</td>
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<tr>
<td>covariance</td>
<td>10%</td>
<td>5%</td>
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</table>

- 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
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Quarterly moments relative to old, 1978-06:

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- St dev log fraction young with old $\approx 0.8$
- Cyclical correlation with hours worked $\approx -0.6$
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:

$$M = \frac{V(\log h_y) - V(\log [\bar{x}h_T + (1 - \bar{x}h_A)])}{V(\log h_y)} \approx 5\%$$
Wages: labor supply or labor demand?

- Living arrangements: labor supply different for young vs old
- Jaimovich, Pruitt, Siu (2013) wages $\rightarrow$ labor demand differences
Wages: labor supply or labor demand?

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- Labor demand story:
  - Technology with imperfect substitutability between old and young
  - Quantitative argument requires Frisch for young = 7, old = ∞

- Alternative - supply side story:
  - Imperfect substitutability by living arrangements implausible
  - Labor supply elasticities for old disciplined by micro estimates
Model
Demographics

Old agents

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

Young agents

• Two independent idiosyncratic shocks
  • Individual productivity $\varepsilon$
  • Distaste for living with old agents $\eta$
• Can invade an old household

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

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

- Standard RA intertemporal problem

\[ V^o(a; w^o, r) = \max_{c^o, h^o, a'} u^o(c^o, h^o) + \beta E \left[ V^o(a'; w'^o, r') \right] \]

s.t. \( c^o + a' = w^o h^o + (1 + r) a \)

- Standard preferences

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

- 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

\[ V^A (\varepsilon; w^y) = \max_{c, h} \frac{c^{1-\gamma}}{1 - \gamma} - \psi_y \frac{h^{1+\frac{1}{\nu_y}}}{1 + \frac{1}{\nu_y}} \]

s.t. \[ c = w^y \varepsilon h \]

• Young together

\[ V^T (\varepsilon, \eta; w^y, c^o) = \max_{c, h} \frac{[c + \zeta(c^o)]^{1-\gamma}}{1 - \gamma} - \psi_y \frac{h^{1+\frac{1}{\nu_y}}}{1 + \frac{1}{\nu_y}} - \eta \]

s.t. \[ c = w^y \varepsilon h \]

• 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)

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

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 \( Z \)
Selection into 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

\[
x(s) = \int_0^\infty \int_{-\infty}^{\eta^*(s, \varepsilon)} dF_\eta \ dF_\varepsilon
\]

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

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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
3. Mean wages of young alone, young together
Parameterization strategy

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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
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 \( \psi^o \): \( E[h^o] \)
- Labor disutility young \( \psi^y \): \( \frac{E[h^y]}{E[h^o]} \)
- Productivity dist \( \varepsilon \): \( \frac{E[w^y]}{E[w^o]}, \frac{E[w^{yA}]}{E[w^{yT}]} \)
- Young preferences \( \gamma, \nu^y \): \( \frac{\sigma[h^y]}{\sigma[h^o]}, \frac{\sigma[h^{yA}]}{\sigma[h^{yT}]} \)
- Implicit transfers \( \zeta_0, \zeta_1 \): \( \frac{E[h^{yA}]}{E[h^{yT}]}, \rho(h, x) \)
- Disutility dist \( \eta \): \( E[x], \frac{\sigma[x]}{\sigma[h^o]} \)
## Model fit

<table>
<thead>
<tr>
<th></th>
<th>Data</th>
<th>Model</th>
</tr>
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<tbody>
<tr>
<td><strong>Relative hours</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$E[h^y]/E[h^o]$</td>
<td>1.00</td>
<td>0.98</td>
</tr>
<tr>
<td>$E[h^{yA}]/E[h^{yT}]$</td>
<td>1.24</td>
<td>1.35</td>
</tr>
<tr>
<td>$\sigma[h^y]/\sigma[h^o]$</td>
<td>1.58</td>
<td>1.57</td>
</tr>
<tr>
<td>$\sigma[h^{yA}]/\sigma[h^{yT}]$</td>
<td>0.69</td>
<td>0.71</td>
</tr>
<tr>
<td><strong>Relative wages</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$E[w^y]/E[w^o]$</td>
<td>0.65</td>
<td>0.64</td>
</tr>
<tr>
<td>$E[w^{yA}]/E[w^{yT}]$</td>
<td>1.44</td>
<td>1.32</td>
</tr>
<tr>
<td>$\sigma[w^y]/\sigma[w^o]$</td>
<td>1.07</td>
<td>1.12</td>
</tr>
<tr>
<td>$\sigma[w^{yA}]/\sigma[w^{yT}]$</td>
<td>1.06</td>
<td>1.04</td>
</tr>
<tr>
<td><strong>Living arrangements</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$\sigma[x]/\sigma[h^o]$</td>
<td>0.75</td>
<td>0.75</td>
</tr>
<tr>
<td>$corr(x, h)$</td>
<td>-0.56</td>
<td>-0.56</td>
</tr>
<tr>
<td>$M$ (%)</td>
<td>5.0</td>
<td>4.5</td>
</tr>
<tr>
<td><strong>Contr F/N (%)</strong></td>
<td>15.3</td>
<td>16.1</td>
</tr>
</tbody>
</table>

*Non-targeted moments.*
Lessons
Size of implicit transfers

\[ \zeta(c^o) = \zeta_0 + \zeta_1 c^o \]

1. Average fraction of consumption of old
   \[ \mathbb{E}\left[ \frac{\zeta(c^o)}{c^o} \right] = 17\% \]

2. Average fraction of consumption of young together
   \[ \mathbb{E}\left[ \frac{\zeta(c^o)}{\zeta(c^o) + c^o y_T} \right] = 49\% \]

3. Average additional hours need to work by young together
   \[ \mathbb{E}\left[ \frac{\hat{h}_y T - h_T y_T}{h_T} \right] = 37\% \]
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 \( \zeta \)
Why does coresidence affect hours?

- Frisch elasticity for old = 0.72
- Marshallian elasticity for young alone
  \[ e^{yA} = 0.45 \]
- Marshallian elasticity for young together
  \[ E[e^{yT}] = 0.73 \]
- 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 \( \zeta \)
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

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<td>$M$ (%)</td>
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<td>-</td>
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*Frisch for the old across experiments is 0.72.*
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?

<table>
<thead>
<tr>
<th>Frisch elasticity for old ($\nu^o$)</th>
<th>Implied Frisch in RA RBC model</th>
<th>Proportional Increase</th>
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<tbody>
<tr>
<td>0.72</td>
<td>1.33</td>
<td>85%</td>
</tr>
<tr>
<td>0.5</td>
<td>0.87</td>
<td>75%</td>
</tr>
<tr>
<td>1.0</td>
<td>2.15</td>
<td>115%</td>
</tr>
<tr>
<td>2.0</td>
<td>9.62</td>
<td>381%</td>
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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

![Log coresidence - Log hours of old](chart.png)
Interpreting 2007-15 dynamics

Log hours of young - Log hours of old

Quarters
-0.025
-0.02
-0.015
-0.01
-0.005
 0
 0.005

h_y/h_o model  h_y/h_o data

Quarters
0 5 10 15 20 25 30 35 40
Interpreting 2007-15 dynamics

Log hours of young away - log hours of old

Quarters

-0.025
-0.02
-0.015
-0.01
-0.005
0
0.005
0.01

h^YA/h^o model  h^YA/h^o data

Quarters

0 5 10 15 20 25 30 35 40
Interpreting 2007-15 dynamics

Log hours of young together - log hours of old

0 5 10 15 20 25 30 35 40
Quarters
-0.04 -0.035 -0.03 -0.025 -0.02 -0.015 -0.01 -0.005 0 0.005
h yT /h o  model h yT /h o  data

Quarters
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.