

**(37) Tuttle, M. H., Gauger, Jean. "Wealth Effects and Consumption." A Multivariate Evaluation." Mimeo, 2003.**

The paper examines the long run and short run dynamic relationship between aggregate consumption, real disposable personal income, and real wealth, including evaluation of potential structural breaks. This is in light of the contrasting conclusions from the two competing lines of argument referred to as "Endogenous Consumption" and "Endogenous Wealth" views, where the former finds empirical evidence of a long run wealth effect on consumption, and concludes that there is endogeneity in consumption indicating that a one dollar change in wealth permanently increases consumption. Conversely, endogenous wealth view supports the idea that it is wealth that permanently responds to changes in consumption, and thus wealth is endogenous, and induces only temporary increases in aggregate consumption.

Investigating the cointegrating long run relationship between these variables during 1952-2002, show parameters of income and wealth of 0.723 and 0.039 respectively. These results presume a constant relationship between the variables, though it is possible that some structural breaks have occurred over the fifty year span of the sample, and conclusions on cointegration can be distorted if no allowance is made for possible structural breaks over time. Tests show that cointegration exists when allowing for structural breaks, and results for cointegration in the presence of structural breaks, considering the 1993 break, show that the estimated long run parameter for disposable income is 0.775 which is larger than the initial result, and that of wealth is 0.023 which is smaller than the initial result.

Examining the adjustment process to restore the long run equilibrium, two vector error correction models are used, where the first excludes any breaks while the second includes the 1993 break. In the former case, the error correction term in the consumption equation is statistically significant indicating that consumption is an adjustment factor, but that it does not adjust rapidly but rather gradually over time. This means that using the methods of the endogenous wealth research, results point to a conclusion more consistent with the endogenous consumption studies. However, the error correction terms in the income and wealth equations are also highly significant indicating that all the variables are endogenous and are involved in the adjustment back to long run equilibrium. Results for the latter case VECM are consistent with the former case, and thus allowing for a break in the cointegrating relationship does not alter basic results for the dynamics of the system.

The authors conclude that there appears to be a long run response in aggregate consumption to changes in wealth and disposable income, though the estimated wealth parameter is small compared to other studies, and results find a smaller adjustment parameter on consumption compared to those obtained in other studies.

