

## **From Income to Consumption: Partial Insurance and the Transmission of Inequality**

### **Abstract**

This paper examines the link between income inequality and consumption inequality through the degree of insurance to income shocks. A new panel data consumption series is created for the PSID using an imputation procedure that maps food data into consumption data using the estimates of a demand function for food obtained from repeated CEX cross-sections. We document a disjuncture between income and consumption inequality in the US over the 1980s and show that it can be explained by changes in the persistence of income shocks. In particular, an initial growth in the variance of permanent shocks is then replaced by a continued growth in the variance of transitory income shocks. Although we find important differences in the degree of insurance by wealth, education, and birth cohort, the overall interpretation of the relationship between consumption and income inequality is maintained. We find some partial insurance of permanent income shocks with more insurance possibilities for the college educated and those approaching retirement. We find little evidence against full insurance for transitory income shocks except among low wealth households. Taxes and transfers as well as family labor supply are found to play an important role in insuring permanent shocks.