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Professor Willem Buiter
London School of Economics

Re: Housing Wealth is not Wealth

Dear Professor Buiter,

First of all, let me apologize for the delay in reaching a decision on your manuscript. I had difficulty finding referees, and I waited (in retrospect, too long) for a referee who had promised a report but never delivered. I have now obtained two referee reports and I have read the paper myself. Both referees view the issue you are dealing with as important and are sympathetic to your analysis and results, although they raise some issues that need to be addressed. Based on what they write and what I think of the current draft, I would recommend the following.

It seems to me and to at least one of the referees that the result of zero wealth effects is rather special and it rests on the specification of the model. The current degree of emphasis makes for fun reading, but may not be doing full justice to your in-depth analysis. For example, you note that differential propensities to consume across young and old agents could generate distributional effects of changes even in fundamental house values but such effects are absent from the model, given its Blanchard-Yaari structure. I would recommend that you start with the statement by Mervyn King, set up your benchmark model as a way to rationalize the statement, describe clearly which assumptions are important for this model, and then spend some time discussing whether these assumptions are necessary, in addition to being sufficient. In discussing the necessity of each assumption, you will be led to consider interesting deviations leading to violations of the King statement. Then you can discuss whether these violations are likely to be quantitatively important or not.

Then, you can take up the two other points that referee 2 finds as your key contributions. First, that the bubble component matters for consumption and in a different way than the fundamental component of house prices. It would be good to link your results to the papers mentioned by the second referee. Referee 1 would like you to explore this strict dichotomy a bit further, pointing out that bubbles often arise as misunderstandings about fundamentals. If one were to pursue this behavioral twist, maybe the nature, size, rate of changes in fundamentals are relevant for the creation and size of the bubble and ultimately for effects on consumption. Is there anything to this idea that should qualify your statements regarding the dichotomy? Would it be straightforward to formalize?

The third contribution identified by referee 2 has to do with current econometric practice of estimating wealth effects. Here the distinction between fundamentals and bubbles is crucial, and you may want to relate your analysis more directly to pitfalls in econometric modeling of housing wealth effects. Is this the only distinction worth making? Here you may link your discussion to the 'robustness' analysis under the first contribution: if aspects of agent heterogeneity are important for wealth effects, what does this tell us about the relative informativeness of macro versus micro data analysis on housing wealth and consumption?

If you are willing to make the above changes, so as to clarify the scope of your result and the potential importance (or unimportance) of factors causing departures from it, I would certainly be willing to consider a revised version for final approval and publication in *E*conomics.