Consumption, Savings, and Earnings Responses to Financial Windfalls*

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Abstract

We estimate the causal effect of a financial windfall on (1) consumption (MPC) using credit report data on credit card spending, (2) savings (MPS) using both tax data on financial assets and credit report data on debt repayments, and (3) labor earnings (MPE) using tax data. To do so, we merge data on 40,000 Canadian lottery winners to their income tax records and credit reports. We also estimate heterogeneity in the marginal propensities across income groups. Our findings reveal substantial heterogeneity in all three terms, with higher-income individuals having a larger MPE and MPS and lower-income individuals having a larger MPC. We develop a simple life-cycle model that allows individuals to vary in their earnings ability and rate of impatience, and show that our model can match our estimated heterogeneous responses if earnings ability and impatience are negatively correlated. Our results have implications for the optimal design of various policies, including fiscal stimulus programs, a universal basic income, and the taxation of income and savings.

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