

Consumption Commitments and Preferences for Risk

Andrew Postlewaite

We examine an economy in which the cost of consuming some goods can be reduced by making commitments to consumption levels independent of the state. For example, it is cheaper to produce housing services via owner-occupied than rented housing, but the transactions costs associated with the former prompt relatively inflexible housing consumption paths. We show that consumption commitments can cause risk-neutral consumers to care about risk, creating incentives to both insure risks and bunch uninsured risks together. For example, workers may prefer to avoid wage risk while bearing an unemployment risk that is concentrated in as few states as possible.