

I. Introduction

Several recent empirical papers have attempted to determine the proportion of either aggregate or household wealth attributable to precautionary saving. Unfortunately, theoretically plausible precautionary saving models are difficult to solve and have been thought to imply no

Equivalent Precautionary Premium (EPP); the second is an atheoretical measure, the log of the variance of the log of income (LVARLY). We show that the buffer-stock model predicts a

The model of precautionary saving that forms the basis of our empirical work is a variant of the “buffer-stock” models developed by Deaton (1991) and Carroll (1992, 1997). Carroll (1992, 1997) shows that these models imply that consumers will have a target wealth-to-income ratio such that if wealth is above the target, consumption will exceed income and wealth will fall, and if wealth is below the target income will exceed consumption and wealth will rise. Carroll (1992) argues that this model is consistent with a variety of characteristics of macroeconomic

where $X_t = Y_t + W$

Carroll (1996) for a derivation).⁷ The particular values we choose for solving the model are $\rho = 3$,

δ

Because total consumption is not reported in the PSID, we cannot construct a measure of uncertainty that corresponds exactly to the REPP.⁸ Instead, we follow Carroll (1994) in substituting permanent and actual income for average and actual consumption (respectively) in the REPP formula; strictly speaking, this is a ‘loose’ measure of the REPP and be identical to the

of panel data on income necessary to calculate distributions of shocks to income. Our method was as follows. We divided

calculated for that distribution. Figure 1b plots $\log w^*$ against VARY, the theoretically appropriate measure of uncertainty under CARA utility. Comparison of

For simplicity, in our empirical work we wished to narrow the field of potential measures

Table 2

Table 3

Robustness Tests

Experiment	Wealth Measure	Coefficient Estimate on REPh65 uf h 1 rëjjj
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Table 4

