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How Important Is Precautionary Saving?

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Abstract

We estimate how much of the wealth of a sample of respondents to the Panel Study of Income Dynamics is held because some households face more income uncertainty than others. We begin by solving a theoretical model of saving, which we use to develop appropriate measures of uncertainty. We then regress households' wealth on our measures of uncertainty, and find substantial evidence that households engage in precautionary saving. Finally, we simulate the wealth distribution that our empirical results imply would prevail if all households had the same uncertainty as the lowest uncertainty group. We find that between 32 and 50% of wealth in our sample is attributable to the extra uncertainty that some consumers face compared to the lowest uncertainty group.

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