

Theoretical Foundations of Buffer Stock Saving

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Christopher D. Carroll¹

Abstract

This paper builds foundations for rigorous and intuitive understanding of ‘buffer stock’ saving models (Bewley (1977)-like models that have a wealth target), pairing each theoretical result with quantitative illustrations. After describing conditions under which a consumption function exists, the paper articulates stricter ‘Growth Impatience’ conditions that guarantee alternative forms of stability — either at the population level, or for individual consumers. Together, the numerical tools and analytical results constitute a comprehensive toolkit for understanding buffer stock models.

Keywords Precautionary saving, buffer stock saving, marginal propensity to consume, permanent income hypothesis, income fluctuation problem

JEL codes D81, D91, E21

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A [dashboard](#) allows users to see the consequences of alternative parametric choices in a live interactive framework; a corresponding Jupyter Notebook uses the Econ-ARK/HARK toolkit to produce all of the paper’s figures (warning: the notebook may take several minutes to launch).

All figures and numerical results can be automatically reproduced using the Econ-ARK/HARK toolkit, which can be cited per our references (Carroll, Kaufman, Kazil, Palmer, and White (2018)); for reference to the toolkit itself see Acknowledging Econ-ARK. Thanks to the Consumer Financial Protection Bureau for funding the original creation of the Econ-ARK toolkit; and to the Sloan Foundation for funding Econ-ARK’s extensive further development that brought it to the point where it could be used for this project. The toolkit can be cited with its digital object identifier, 10.5281/zenodo.1001067, as is done in the paper’s own references as Carroll, Kaufman, Kazil, Palmer, and White (2018).

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¹Contact: ccarroll1@jhu.edu, Department of Economics, 590 Wyman Hall, Johns Hopkins University, Baltimore, MD 21218, <https://www.econ2.jhu.edu/people/ccarroll>, and National Bureau of Economic Research.

1 Introduction

In the presence of realistic transitory and permanent shocks to income *a la* Friedman (1957) and Muth (1960), only one further ingredient is required to construct a microeconomically testable model of consumption: A description of preferences. Zeldes (1989) was the first to calibrate a quantitatively plausible example; his paper spawned a literature showing that such models' predictions can match household life cycle data reasonably well, whether or not explicit liquidity constraints are imposed.¹

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¹See Carroll (1997) or Gourinchas and Parker (2002) for arguments that models with only 'natural' constraints (see below) match a wide variety of facts; for a model with explicit constraints that produces very similar results, see, e.g., Cagetti (2003).

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