The Effects of Economic Insecurity on Household Savings

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Building upon recent advances in the measurement of Economic Insecurity this paper empirically examines the extent to which economic insecurity affects household savings behaviour and the consumption of durables. Traditional certainty-equivalence models of savings predict that the marginal propensity to consume out of future income is independent of the riskiness of this income (Browning and Lusardi 1996). In contrast, we predict that the volatility of the income stream has an important effect on the percentage change in household savings rates and accumulation of assets in the form of durable goods. Using panel data where information on wealth and durables is available (such as the Korean Household Panel and the Survey on Household Income and Wealth of Italy), we proceed by empirically measuring economic insecurity using the Bossert - D’Ambrosio and the ESI indices and then examine how it affects household savings and the consumption of durables, such as vehicles, refrigerators and other relatively big ticket consumer durables.

Economic Insecurity and Precautionary Savings
A salient effect of the 2009 financial crisis and its subsequent recession was the sudden and large upsurge in household savings that was driven by the loss of consumer confidence. During the second quarter of 2009, US household savings reached 5.2 per cent – the highest level reached in a decade. Around the world, as unemployment grew and financial stocks plummeted, households increased savings and cut back spending on luxuries and durables. In economic theory, the concept of “precautionary savings” has a long tradition in economics and played a prominent role in Keynes’ General theory (1936). However, much the recent of literature on savings still attempts to account for savings behaviour as being mainly a result of households wanting to smooth their consumption over future periods.

To progress thinking about precautionary savings, this paper seeks to empirically link savings dynamics with recently developed measures of economic insecurity. To date, few theoretical connections have been made between the newly emerging literature on economic insecurity and the relatively well-established literature on savings. Economic insecurity has been a topic of increasing interest in academic literature over recent years. The term ‘insecurity’ used to refer to a state of psychological anxiety about one’s financial future (Hacker (2006), Osberg (1998, 2010), Osberg and Sharpe (2002, 2008) and Sharpe and Osberg (2009)). If economic insecurity is high or increasing, this could be of concern as there are significant negative psychological effects associated with risks and uncertainty which should be included in an understanding of how personal or household finances translate into economic welfare.

As such, it appears there would be clear connection to savings behaviour: the more insecure households are feeling, the more likely they are to build up savings. This “precautionary” motive
has been discussed in the savings literature since Keynes (1936), who argued that households “build up a reserve against unforeseen contingencies”. It is interesting to note that the savings literature on savings has recently devoted much attention to how uncertainty affects savings behaviour (Deaton 1992, Ch.4). In particular, the traditional life cycle model of saving tends to rely on the unrealistic assumption that future incomes, interest rate and preferences are known with certainty. It thus does not allow for updating of savings behaviour in light of new information.

**Empirical Procedure**

We adopt a ‘two-stage’ approach to studying how economic insecurity affects savings in two ways. The first approach consists of examining how economic insecurity (as measured by the forward looking Bossert and D’Ambrosio index and the ESI index) can be used to predict changes in savings behaviour. The second approach will be to examine how the same change in economic insecurity will affect the consumption of durable goods, which can be considered to be a type of household asset. If household are feeling insecure, they may be less likely to purchase big-ticket items such as refrigerators. This represents another form of saving in the sense that consumers prefer to keep their assets in a more liquid form if they experiencing high levels of insecurity. Both approaches will seek to control for the affect that household income levels has on consumption on saving and the consumption of durables.

**References:**


Deaton, A. (1992), Understanding Consumption, Clarendon Lectures in Economics, Oxford University.


