Liquidity Constraints and Dissaving

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Researchers have assumed that liquidity constraints prevent households from engaging in consumption smoothing. We investigate this proposition by analyzing reported household dissaving using as a dependent variable a dichotomous, indirect measure representing whether the household spent more than income during the previous year. This variable is based on three SCF questions and created using SAS code provided on the Federal Reserve Board (See Yuh and Hanna 2010 article in *Journal of Consumer Affairs*). A household is designated as dissaving if the respondent reported that spending was more than income during the past year (not including spending on investments). In the 1995-2004 period, 15% of households in the Surveys of Consumer Finances reported spending more than income. We find that liquidity constraints do not seem to inhibit dissaving as measured by respondent reports. Borrowing constrained households are more likely to report spending more than income than unconstrained households. Black households are more likely than otherwise similar White households to report dissaving. The likelihood of dissaving decreases as net worth increases from zero, but increases as net worth decreases from zero. The multivariate results for spending more than income are partly consistent with our expectations based on a standard life cycle model and precautionary savings considerations. Some of the results not supporting the hypotheses for spending more than income might be related to timing issues. For instance, the hypothesis that those who are not covered by health insurance should dissave less than those who are covered by health insurance is based on the assumption that the impact of insurance relates only to planning for the future. If households not covered by health insurance are currently experiencing higher expenditures for medical bills, then their higher likelihood of spending more than income is not surprising. Some of the other effects contrary to our hypotheses might be due to systematic differences in households related to time preferences. For instance, households that are unsure about future income might also be more present oriented than households that are sure about future income. Analysis of panel data is needed to investigate the anomalies found.

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