Aggregate Implications of Microeconomic Consumption Behavior

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Macroeconomists pursuing microfoundations for aggregate consumption have typically adopted one of two approaches: Either model microeconomic behavior carefully and then aggregate, or start with a representative agent model, then introduce microeconomic heterogeneity. The 'bottom up' approach has concluded that saving induced by idiosyncratic uncertainty can profoundly change behavior. The 'top down' approach has found that individual risk is of little importance. This presentation will review the debate and then argue that while general equilibrium effects do imply that the aggregate magnitude of precautionary saving is modest, uncertainty nevertheless produces macroeconomic dynamics and policy implications that are very different from those produced by the representative agent framework. The key to this conclusion is the concavity of the consumption function.

1 A Tractable Model of Buffer Stock Saving

Setup of the standard microeconomic model. Concavity of the consumption function. Target saving behavior. Reference: Carroll and Toche (2009)

2 The Ergodic Distribution of Assets

Equilibrium heterogeneity of wealth levels. Implications for tax and monetary policy. Reference: Carroll (2009)

3 Macroeconomic Dynamics: Theory

'Approximate aggregation' and the representative agent model. Reference: Krusell and Smith (1998), Carroll (2000)

4 Macroeconomic Dynamics: Evidence

Excess smoothness. Reference: Carroll, Sommer, and Slacalek (2010).

References

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