Permanent Income and The Financial Behavior of Households

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Abstract

The research focuses on examining the impact of permanent income on household consumption across various income levels. To achieve this, macroeconomic data from selected countries (Georgia, Armenia, Azerbaijan, Russia, Turkey, Estonia, Lithuania, Latvia, the Netherlands, Austria and Switzerland) were analyzed. Additionally, data on the income and expenditures of Georgian households were scrutinized across four income levels. The Evans (1967) consumption function served as the foundation for our research, drawing on data from the IMF and the Household Income and Expenditure Survey done by Geostat. Relevant issues were addressed by referring to previous studies by Friedman (1957), Evans (1967), Helliwell (1998), Blundell, Pistaferri, and Preston (2008), Attanasio and Weber (2010), Jappelli, and Pistaferri (2017). The research findings indicate that marginal propensities to consumption from permanent income are within the range of 0.93-0.98 across the studied countries, a pattern similarly observed in Georgia (0.94-0.99) among households with varying income levels. The significance of current income within permanent income varies notably among different country groups and household income levels. European Union member countries exhibit a lower parameter variation compared to the second group of countries. To explore these differences, the study examines the intertemporal preference of consumption and its elasticity. Analysis of these indicators provides insights into diverse financial behaviors observed in distinct groups. Specifically, the research notes that low levels of intertemporal preferences and elasticity of consumption in relation to interest rates correlate with a high level of savings, consistent with the Keynes-Ramsay rule.

Keywords: Consumer intertemporal preferences; Household consumption; intertemporal elasticity of substitution; Keynes-Ramsay Rule; Marginal propensities to consumption

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