Where Have All the Savings Gone?

Ever since Ben Franklin wrote "A penny saved is a penny earned," Americans have been taught that saving is a virtue.[1] Having accepted this principle, many economic observers are concerned about the recent sharp decline in America's personal saving rate. Many economists are also concerned because they believe personal saving is a requisite for economic growth and progress. Such progress requires a steady stream of investment expenditures for the development of new technologies and for the purchase of new plant and equipment. To generate this investment stream, society must forgo current consumption so resources can be diverted from the production of consumer goods to the production of capital, or investment, goods. Saving, then, is the means by which resources are diverted from current consumption to future growth.

As can be seen in Chart 1, the personal saving rate has moved irregularly downward since 1980 and by 1998 was close to zero. The Bureau of Economic Analysis (BEA) rate actually dropped below zero in 1998 and has remained negative in 1999.[2]

The near-zero and negative monthly personal saving rates for 1998 and 1999 represent a dramatic break with the past. Monthly saving rates in the late 1970s and early 1980s generally oscillated between 6 percent and 10 percent, with a spike up to 13.6 percent in 1980 (Federal Reserve series). Since the early 1980s, however, the rate of personal saving has shown a marked decline, interrupted only by a modest recovery between 1989 and 1992. The average monthly saving rate for 1988–91 (5.5 percent) was one-fourth lower than that for 1975–81 (7.2 percent). More recently, the 1995–98 rate (2 percent) was only about one-fourth that of 1975–81.

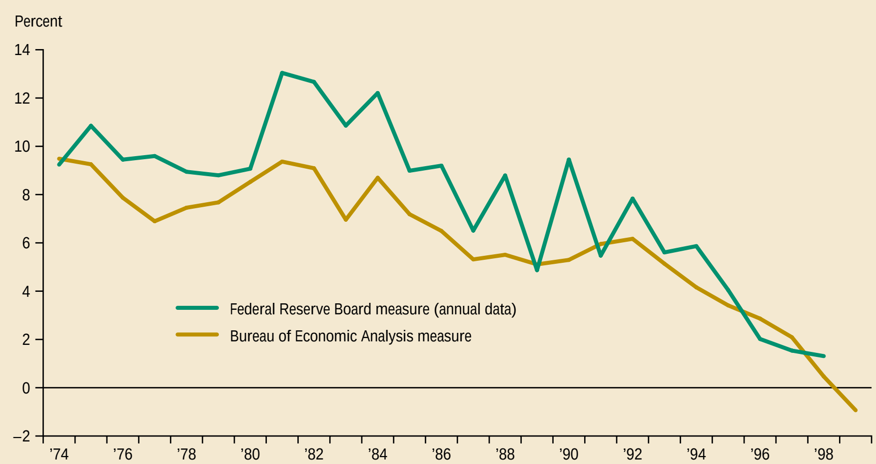
The persistent decline in the personal saving rate seems paradoxical, as American living standards have been steadily improving and the nation's stock indexes rising.[3] Commentators have sought to explain this phenomenon by pointing to policy decisions or the economic trends of the past two decades. Tax rate increases adopted in 1990 and 1993 and the rising trade deficit have been popular targets. Some economists speak of a change in the very nature of Americans—from Ben Franklin-like good citizens who see saving as a virtue to profligate consumers who see conspicuous consumption and even excess debt as privileges of an advanced economy infected with "luxury fever."[4] Both the current administration and Congress have proposed legislation to address America's alleged inadequate saving rate. It is now a virtual media pastime to bemoan the nation's profligacy and the problems our current "consumption-binge" mentality is bound to create for future generations.

Should we worry about the saving rate trend? If today's saving behavior is a rational, healthy response to economic conditions, we can ignore the rhetoric about approaching disaster. When one looks at the entire economic picture and employs better indicators of the consumption/saving trade-off than the simple personal saving rate, the often-invoked "savings crisis" disappears. This is important because it means we can stop fretting over whether economic growth will suffer and whether Americans will have sufficient resources for their futures.

Why Saving Is Higher Than It Appears

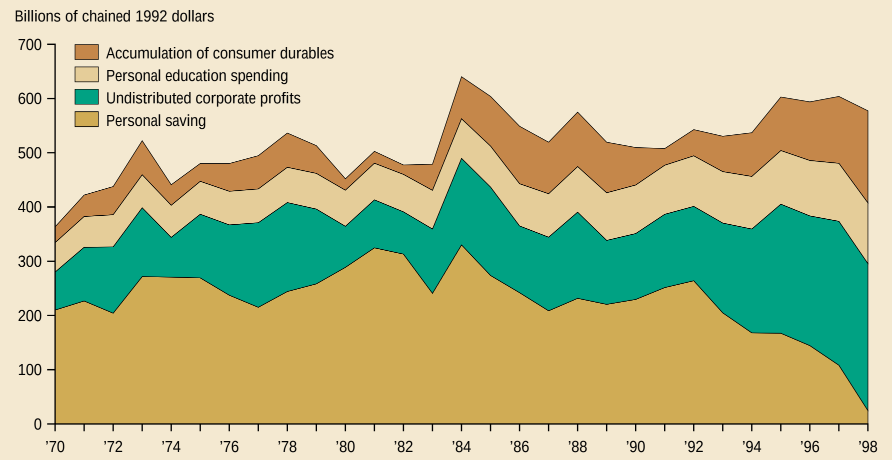
To save is to postpone consumption. A nation saves when a portion of current output is not consumed today but set aside for the future as either finished goods or capital investment. Actually, America's personal saving might be higher than it appears in Chart 1 because the chart does not include all forms of saving (nonconsumption). The personal saving rate is derived by dividing personal savings of all Americans by their aggregate personal disposable income. But these terms do not mean what most Americans might think be-

Chart 1
Personal Saving Rate



SOURCES: Federal Reserve Board; Bureau of Economic Analysis.

Chart 2
Personal Saving and Related Items



SOURCE: Bureau of Economic Analysis.

Perhaps personal saving isn't even the right statistic to analyze when seeking to understand America's consumption/ investment trade-offs.

cause personal saving is not calculated by adding up the various saving instruments of the population. On the contrary, the personal saving rate is an accounting construct calculated by subtracting personal consumption expenditures from personal disposable income (the latter being personal income less taxes), then dividing the result by personal disposable income. Derived in this manner, the personal saving rate does not include corporate saving, the accumulation of consumer durables or human capital expenditures.

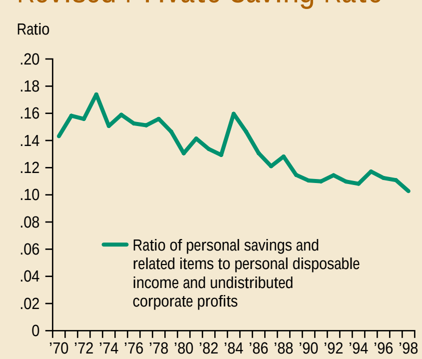
Chart 2 illustrates the effects of including these related economic magnitudes in private sector saving. The chart adds to personal saving the net accumulation of consumer durables, undistributed corporate profits—which the BEA includes in private saving but not in personal saving—and human capital investment as measured by personal education expenditures.[5] Not surprisingly, this chart gives a brighter picture of what Americans are doing with their incomes. As Chart 3 shows, they are currently saving at an annual rate of about 10.25 percent of their personal income.[6]

People do not save for the sake of saving. They save to spread consumption over their lives. It is interesting to note, then, that when they purchase durable goods or education, the official saving rate falls. In fact, Americans' spending on durables and education is rising faster than income. Certainly, some of these expenditures may not prove effective in providing for future consumption, and our savings definition is open to criticism on those grounds. Nevertheless, these additions need to be carefully considered before drawing the conclusion that the savings sky is falling.

Net Worth: The Missing Variable?

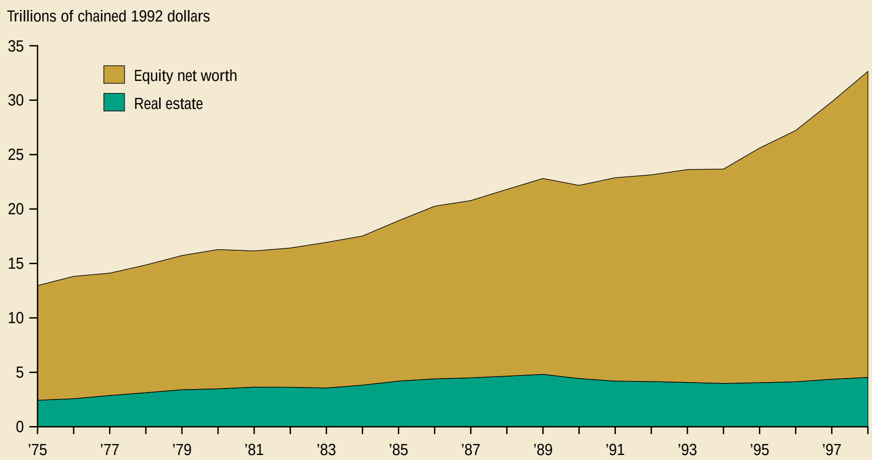
Perhaps personal saving isn't even the right statistic to analyze when seeking to understand America's consumption/ investment trade-offs. Americans save by accumulating a portfolio of assets, some financial and some nonfinancial (durables and education expenditures, as previously noted). If the value of

Chart 3
Revised Private Saving Rate



SOURCE: Authors' calculations.

Chart 4
Private Sector Net Worth



SOURCE: Federal Reserve Board.

Americans' total portfolio rises, their net worth rises and less immediate saving is required. In fact, we ought to see an inverse relationship between what the Commerce Department calls personal saving and overall net worth, and we do. Chart 4 shows real net worth rising at a record rate since the mid-1980s.

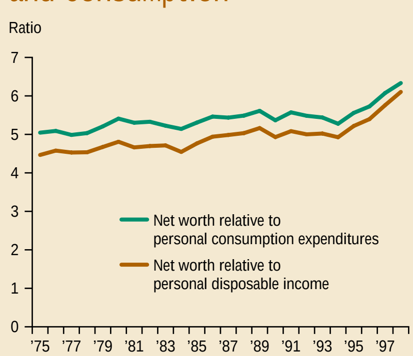
The value of stock portfolios rose from $7.2 trillion in 1996 to $10.8 trillion in 1998, a staggering 50 percent increase in just two years. And the equities market has continued to climb to new records in 1999. The present net worth of all U.S. households is $36.8 trillion, almost double the 1996 combined GDPs of the world's five largest economies—the United States, Germany, France, Great Britain and Japan. At the same time, according to the Federal Reserve's funds flow report, consumer debt has grown more slowly than asset appreciation.

Americans are taking on more debt because they can afford to. Chart 5 shows that households hold more than six times their current incomes as net assets. Not surprisingly, as Chart 6 clearly shows, they have increased their consumption, and their ability to spend comfortably, as their net worth has risen. As opportunity, stability, low unemployment and economic growth have become the new American economic norm, the simpler "saving or consumption" world has become obsolete. For this reason, we should not expect participants in an evolving, national market economy to save, year after year, some predictable, constant percentage of their income.

As the nation's wealth, demographic makeup and economic opportunities change, so might the personal saving rate. What we have shown thus far is that when a definition of asset accumulation more comprehensive than "personal saving" is used, the so-called savings crisis largely disappears. Americans are spending today as if they believe that not only is there a tomorrow, but it's going to be a very good one.

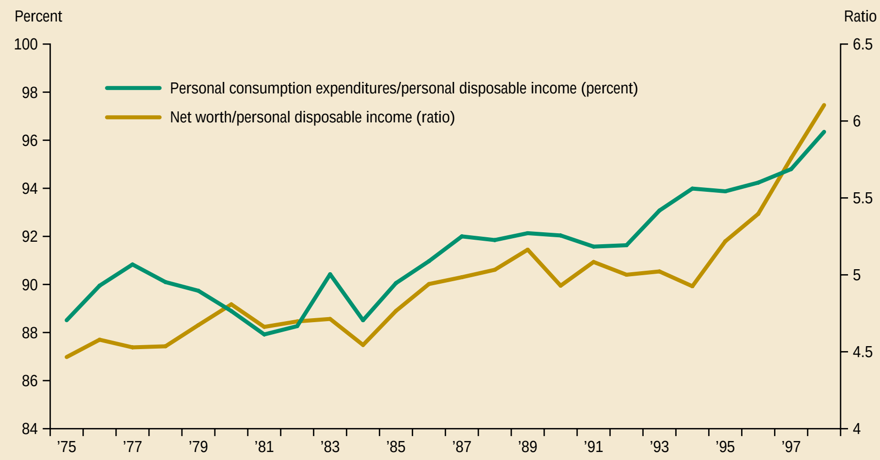
The present net worth of all U.S. households is $36.8 trillion, almost double the 1996 combined GDPs of the world's five largest economies—the United States, Germany, France, Great Britain and Japan.

Chart 5
Net Worth, Personal Income and Consumption



SOURCES: Federal Reserve Board; Bureau of Economic Analysis.

Chart 6
Consumption and Net Worth



SOURCES: Federal Reserve Board; Bureau of Economic Analysis.

Americans now face a number of disincentives to save. Several current government policies discourage saving.

Some Policy Considerations

No economist or government agency knows the economically optimal allocation between current and future consumption. Only individuals can make such choices, and they do so based on their goals, means, expectations and *incentives*. Even though U.S. private saving has declined less than critics claim—and asset accumulation not at all—it may still be desirable for Americans to save more to stimulate private investment and capital formation. Americans now face a number of disincentives to save. Several current government policies discourage saving. Some possible changes that would increase saving are as follows:

- Tax consumption, not income. Taxing income only when spent—not when saved—would encourage private saving and asset accumulation. Under certain assumptions, equivalent results could be achieved by eliminating the tax on capital income, such as dividends, interest and capital gains. Either of these reforms would eliminate the double tax currently imposed on savers.
- Reduce or eliminate the corporate income tax. Short of eliminating tax on all capital income, repeal of the corporate income tax would reduce the overly burdensome tax on saving and investment in U.S. business. Investors in U.S. corporations currently pay three taxes—one when the money is earned, one when the business earns a profit (the corporate profits tax) and one when the dividends are paid out to shareholders. Saving and investment thus suffer.
- Reduce or eliminate the "death" tax. The estate and gifts tax has become increasingly onerous in recent years as markets have lifted Americans' wealth above the untaxed household ceiling (currently $650,000 and rising to $1 million in 2006). Eliminating this tax would encourage private saving, especially lifetime wealth accumulated in family-owned businesses and farms, which under current law often must be sold to pay the tax.
- Simplify and stabilize the tax code. A small, simple and predictable tax is best for stimulating economic activity, including saving. When the tax code is difficult to understand and interpret, or subject to frequent and extensive revision, private saving suffers.
- Reform the federal bankruptcy code. Generous federal bankruptcy laws encourage citizens to spend and borrow without consequence. Tightening the laws would encourage Americans to accumulate wealth, not debt.

Conclusion

The general query "Is America saving enough?" is probably not answerable. For years, many policy commentators have warned that frugal Japan would someday overtake America as the world's premier economic power. That was before the Japanese economy sank, many of its larger banks encountered financial difficulties, and its stock and real estate markets collapsed. Japan's high national saving rate did not prevent economic turmoil, nor is it helping Japan overcome it. What policy advice has Japan received from the same commentators who decry America's profligate ways? Consume more and save less!

It has probably always been the case that some people save too much and others save too little, at least from the perspective of third-party observers. But since individuals differ in their goals, it is problematic to evaluate the saving of an entire nation. In view of the arguments presented here, though, it is clear that pessimism regarding Americans' saving is largely unfounded.

We should remember that our national income accounting definitions were created in another era—one dominated by physically countable manufactured and agricultural output. Today, information and services are the twin pillars on which the growth and prosperity of our economy rest. It does us little good to continue attempting to navigate tricky public policy shoals with antiquated national income and product accounts gauges. As our economy and economic theories change, so must our methods of measurement. Only then can we hope to accurately judge whether Americans are saving too little…or too much.

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Notes

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1 Old Ben understated his case. A 22-year-old who saves a penny and receives the average rate of return of the S&P 500 across the intervening years will have 32 pennies when he retires at age 67.

2 On September 8 of this year, the Commerce Department's Bureau of Economic Analysis announced it has decided to revise the calculation, retroactively to 1929, of several macroeconomic variables, including the personal saving rate. Government workers' pension contributions will now be counted as personal, rather than government, saving. While this does not change GDP, it does increase the personal saving rate by an estimated 1.5 percent to 2 percent, or about $100 billion in the 1990s alone.

3 W. Michael Cox and Richard Alm, *Myths of Rich and Poor: Why We're Better Off Than We Think* (New York: Basic Books, 1999).

4 Robert H. Frank, *Luxury Fever: Why Money Fails to Satisfy in an Era of Excess* (New York: Free Press, 1999). The *New York Times* agrees: Stephen Roach, "Spending Ourselves into Oblivion," December 11, 1998, p. 35.

5 The net accumulation of consumer durables taken from BEA data represents purchases less depreciation. For human capital expenditures, no official data series exists to use as a basis on which we could reliably measure and subtract depreciation. Also, we have revised only the private side of saving, ignoring the upward trend in government saving. Federal, state and local government surpluses make up part of *national* saving and must be considered before making judgments about a "savings crisis."

Just prior to publication, we became aware of similar work by William Gale and John Sabelhaus ("Perspectives on the Household Saving Rate," *Brookings Papers on Economic Activity*, no. 1, 1999, pp. 181–224), who reach similar conclusions, although we were working independently. Although their revised savings definition is not the same as ours, they estimate about a 2 percent decline in saving during 1975–98, consistent with what we found.

6 The ratio we use in Chart 3, personal savings and related items/personal disposable income and undistributed corporate profits, has been relatively stable since 1970, peaking at 17 percent in 1973 and moving slightly downward during the following decade but never varying during that decade by more than 2 percent. To avoid artificially increasing the ratio, we add undistributed corporate profits to the denominator as well as to the numerator.

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