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# Where Have All the Savings Gone?

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ROBERT L. FORMAINI AND  
RICHARD B. MCKENZIE

Ever since Benjamin Franklin wrote “A penny saved is a penny earned,” Americans have been taught that saving is a virtue.<sup>1</sup> Having accepted this principle, many economic pundits are concerned by the recent sharp decline in the U.S. personal saving rate. They are also concerned because they believe that 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 plants and equipment. To generate that investment stream, society must forgo current consumption so that 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, via investment, to greater future income and consumption.

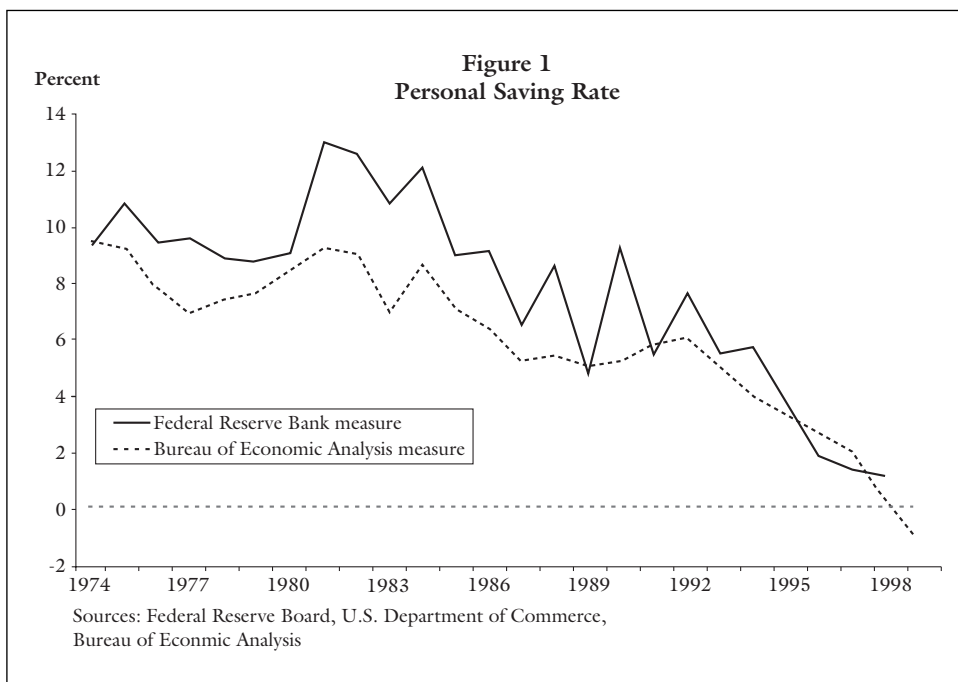
As figure 1 shows, the personal saving rate has moved irregularly downward since 1980, and by 1998 it was close to zero. During four months of 1998 (June, September, October, and December), the rate as measured by the Bureau of Economic Analysis

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

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(BEA) was actually negative, albeit only slightly so at  $-0.3$  percent.<sup>2</sup> More recent data, though still provisional, indicate a continuation of the downward trend (Kulich 2000).

The near-zero and negative monthly personal saving rates for 1998 represented a dramatic break with the past. The monthly saving rate 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 from 1988 to 1991 (5.5 percent) was one-fourth lower than that from 1975 to 1981 (7.2 percent). More recently, the 1995–98 saving rate (2 percent) was only about one-fourth that of 1975–81.

The persistent decline in the personal saving rate seems paradoxical because American living standards have been steadily improving and U.S. stock indexes rising (Cox and Alm 1999). 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

2. On September 8, 1999, the Bureau of Economic Analysis announced that it would revise, retroactively back to 1929, the calculation of several macroeconomic variables, including the personal saving rate. Government workers' pension contributions will now be counted as personal rather than government saving. Although this change does not alter gross domestic product (GDP), it does increase the personal saving rate by an estimated 1.5 to 2 percent, adding about \$100 billion in the 1990s alone.

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” (Frank 1999, Roach 1998). Both the Clinton administration and members of Congress have proposed legislation to raise the allegedly inadequate saving rate in the United States. 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 this saving-rate trend? No. If today’s saving behavior is a rational, healthy response to current economic conditions, we can ignore the rhetoric about approaching disaster. When we look at a broad economic picture and employ better indicators of the consumption-versus-saving trade-off than the simple personal saving rate, the oft-invoked “savings crisis” disappears. This finding is important because it implies that we can stop fretting over whether economic growth will suffer and whether Americans will have sufficient resources for their futures.

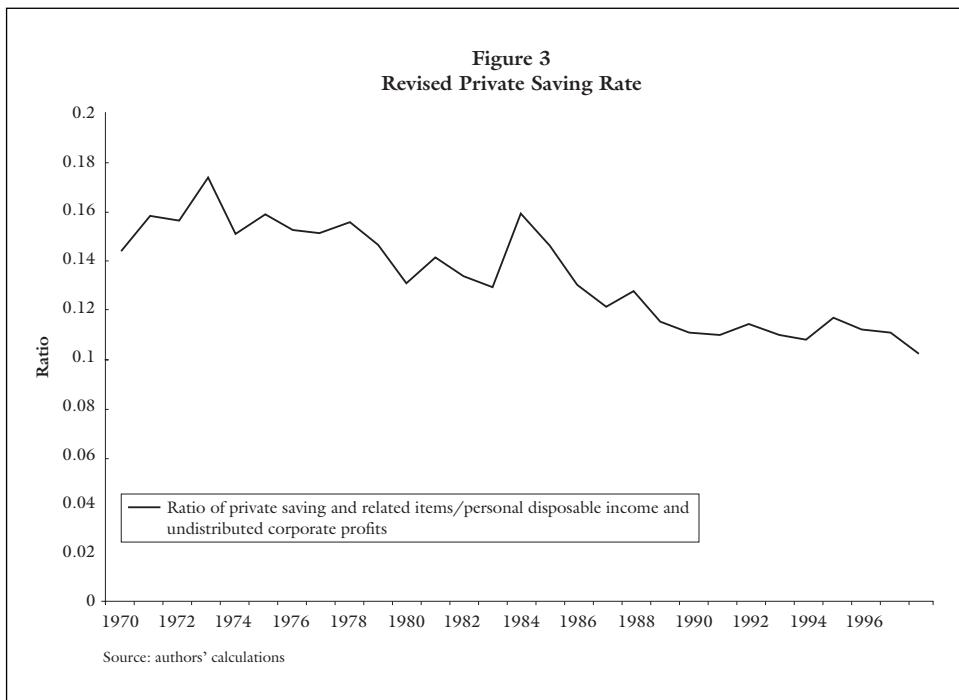
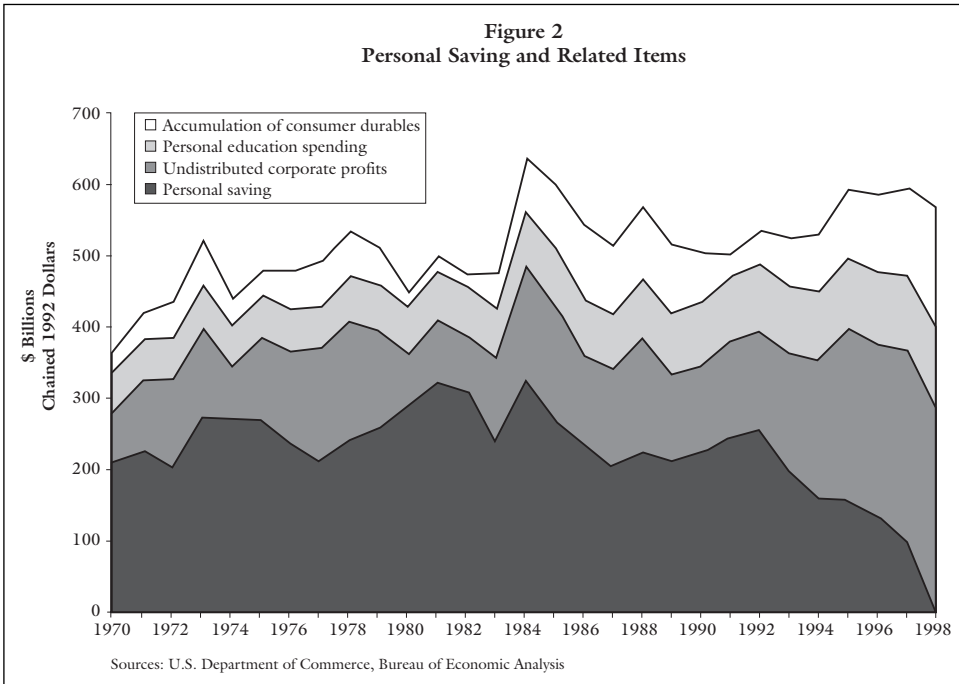
### Why Saving Is Higher Than It Appears

To save is to postpone consumption. A nation saves when a portion of current output is not consumed currently but set aside for the future as either finished goods or capital investment. Actually, personal saving might be higher than it appears in figure 1 because the figure does not include all forms of saving (nonconsumption). The personal saving rate is derived by dividing the personal savings of all Americans by their aggregate personal disposable income. But these terms do not mean what most Americans might think because 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 that difference by the amount of personal disposable income. Derived in this manner, the personal saving rate does not include corporate saving, the accumulation of consumer durables, or expenditures that constitute investment in human capital.

Figure 2 illustrates the effects of including those related economic magnitudes in private saving. The figure 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 investment in human capital as measured by personal education expenditures.<sup>3</sup> Not surprisingly, this figure gives a brighter picture of what

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3. The net accumulation of consumer durables taken from BEA data represents purchases less depreciation. For expenditures on human capital, 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 constitute part of *national* saving and must be considered before one makes judgments about a “savings crisis.”

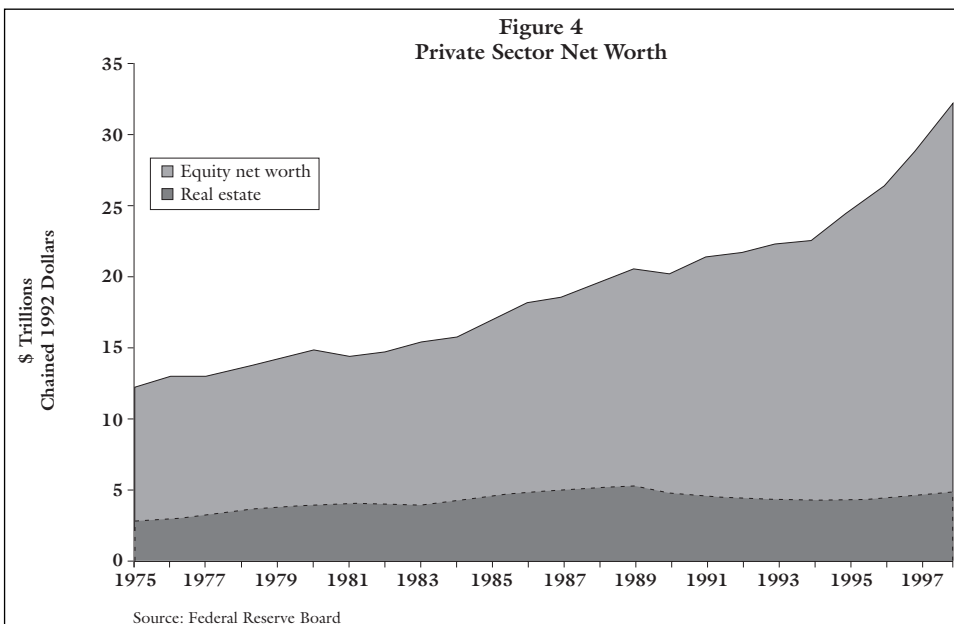


Americans are doing with their incomes. As figure 3 shows, they are currently saving at an annual rate of about 10.25 percent their personal income.<sup>4</sup>

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 their income. Certainly, some of those expenditures may not prove effective in generating future consumption, and our savings definition is open to criticism on those grounds. Nevertheless, we believe 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 is not even the right statistic to analyze when seeking to understand the consumption-versus-investment trade-off. Americans save by accumulating a portfolio of assets, some financial and some nonfinancial, including durables and education, as previously noted. If in the aggregate the value of 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. Figure 4 shows real net worth rising at a record rate since the mid-1980s.



4. The ratio we use in figure 3—(personal savings and related items)/(personal disposable income)—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.

The dollar 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 continued to climb to new records in 1999. The present net worth of all U.S. households is \$36.8 trillion, an amount almost double the 1996 combined gross domestic products (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 funds-flow report, consumer debt has grown more slowly than asset appreciation.

Americans are taking on more debt because they can afford to do so. Figure 5 shows that households hold more than six times their current incomes as net assets. Not surprisingly, as figure 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 U.S. economic norm, the simpler “saving or consumption” world has become progressively obsolete. For this reason, the participants in an evolving, national market economy should not be expected to save some predictable, constant percentage of their income year after year.

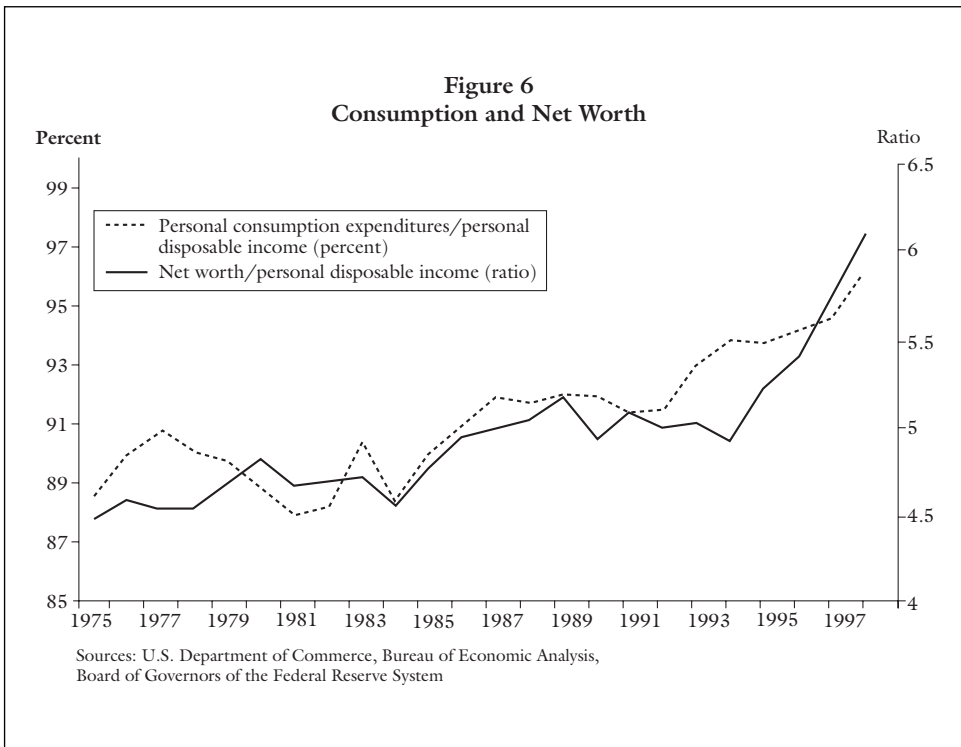
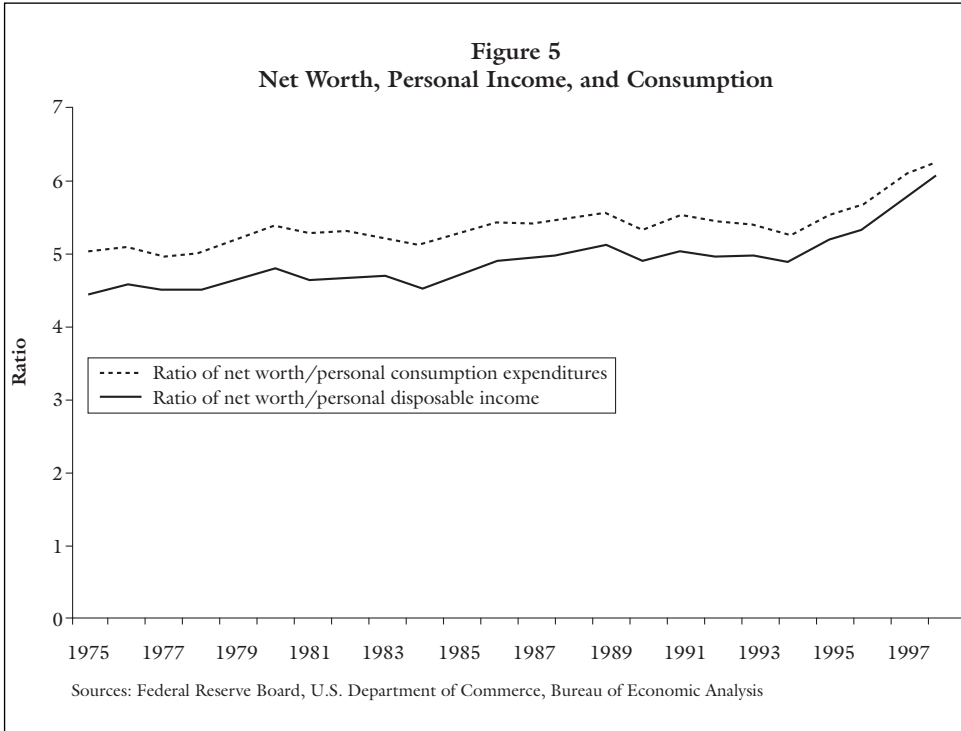
As the nation's wealth, demographic makeup, and economic opportunities change, so might the personal saving rate. What we have shown thus far is that when a definition of asset accumulation more comprehensive than “personal saving” is used, the so-called saving crisis largely disappears. Americans are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

### 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. They now face a number of disincentives in choosing to save. Several current economic policies discourage saving and could be changed to increase it. Some possible changes include:

*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 private 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 is 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 bankruptcy law would encourage Americans to accumulate wealth, not debt.

## Conclusion

The general query "Are Americans saving enough?" is probably not answerable. For years, many of our policy commentators warned us that frugal Japan would someday overtake the United States as the world's premier economic power. That warning came before Japan's economy sank, its large banks failed, and its stock and real-estate markets collapsed. Japan's high national saving rate did not prevent economic turmoil, nor is it helping the Japanese to overcome it. What policy advice have the Japanese received from the very same commentators who decry Americans' 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 because individuals differ in their goals, it is problematic to evaluate the saving of an entire nation. In view of the arguments, though, it is clear that pessimism regarding Americans' saving is largely unfounded.

We should remember that our national-income-accounting definitions were created in an era 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-account gauges. As our economy and economic theories change, so must our methodologies for measuring those changes. Only then can we hope to judge accurately whether Americans are saving too little or too much.

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