

No Saving Crisis In The United States

MEASURES OTHER THAN THE PERSONAL SAVING RATE PUT THE SAVING "CRISIS" IN PERSPECTIVE.

By Richard D. Rippe



Richard D. Rippe is Senior Vice President and Chief Economist, Prudential Securities, New York, NY. He is a past president of NABE (1990-91) and also a Fellow. He thanks Rita Lavin and Philip Laverson for their expert research assistance. This article was excerpted (with updated data) from "There Is No Saving Crisis," Economic

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This paper assesses the saving picture from several perspectives. The consumer sector is not severely strained by low saving, in part because of dramatic gains on the balance sheet. Moreover, the national saving rate has been advancing while the personal portion has declined. By international standards, conventional measures of gross saving make U.S. performance look poor, but after several corrections the picture is much more favorable. Although these findings are primarily positive, the United States should consider sensible policy initiatives that would either consolidate the recent gain in national saving or bolster it further.

The personal saving rate in the United States fell to virtually zero in the second half of 1998, and, in early 1999, it has been negative. The last time the saving rate was negative was in 1933. These results have evoked two sorts of concerns: (1) the country is being profligate in its spending on current consumption and will be unable to finance adequate investment; (2) consumers may have nearly exhausted their spending power and are headed for a retrenchment. Such a development could threaten the current economic expansion.

Personal Saving Has Declined Sharply

The conventional measure of personal saving is presented as part of the National Income and Product Accounts (NIPAs). The familiar calculation is that taxes (personal tax and nontax payments) are deducted from personal income to reach disposable personal income. Then outlays—mainly consumption expenditures but also interest paid by persons and personal transfer payments to the rest of the world—are deducted from disposable income to reach saving; the personal saving rate is saving divided by disposable personal income. The pattern in recent years has been a steady decline (Figure 1); the preliminary data for the first quarter show a negative reading of 0.5 percent.

Traditional Measurement Questions Arise

It has long been recognized that computing saving in the manner done in the NIPAs opens the possibility of substantial errors: As the difference between two large quantities, disposable income and personal outlays, a relatively small error in either will be a large error in saving. Moreover, a host of source data and statistical techniques are used to compute income and consumption. Deficiency in any of the underlying sources can give rise to error in the aggregate. It may be hoped, of course, that errors will tend to offset—either within the calculation of income or consumption or between the two aggregates—but there is no guarantee that will happen.

One particular source of potential error is imputations that are used to estimate magnitudes that cannot be directly observed. These indirect ways of estimating several key components are sizable in aggregate: In GDP for 1997, imputations in total were \$1,059.7 billion, or 13.1 percent of current dollar GDP. With respect to the items that enter the saving calculation, 11.2 percent of disposable personal income and 9.9 percent of personal outlays were imputed in 1997. Again, any error in these calculations could have a meaningful effect on the saving level. A number of the imputations concern the expenditures and income generated by owner-occupied housing—always a thorny issue. In the case of housing, however, it is helpful that a number of these imputations appear in both income and outlays; thus they are offsetting when the latter is subtracted from the former.

Stock Market-Related Measurement Issues Have Become Prominent

The rising stock market and a number of conventions related to the impact of capital gains have also affected the saving rate. In recent years they have all worked to lower measured saving.

In the July 1998 revisions to the NIPAs, the Bureau of Economic Analysis changed the way mutual fund distributions are counted. In the past, all such payouts had been treated as dividends and hence included in personal income. But in fact, some of them are capital gains, which are not supposed to be included in the NIPA data. Removing mutual fund capital gains reduces income, saving, and the saving rate, the latter by about 1.5 percent in 1997.

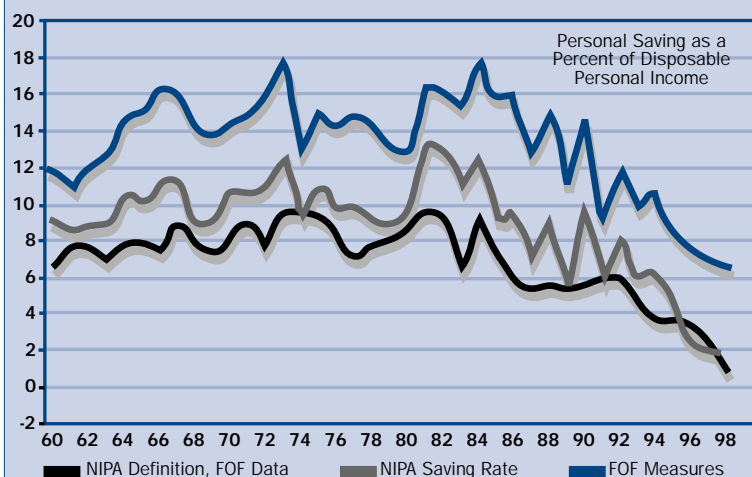
Capital gains from any source are not included in income, because they represent a revaluation of assets rather than income generated from current production. But among the tax liabilities that are deducted from personal income to arrive at disposable personal income, levies on capital gains are included. So in a strong stock market, such as we have recently experienced, more capital gains are being realized, which boosts tax liability. Yet no benefit is being recognized in the income numbers, so the consequence is a reduction in measured saving.

Corporate contributions to pension funds and profit-sharing are counted in personal income, even though funds are not immediately available to consumers. As stock prices have risen, pension plans have become fully funded (or overfunded), and corporations have either reduced their contributions or kept them unchanged. As a result, the component of income that includes pension contributions (other labor income, pension and profit-sharing) slowed sharply in 1995, actually declined in 1996, and then advanced more slowly than overall personal income in 1997. Even though pension assets benefited, the saving rate was reduced.

Although the total impact of higher stock prices on capital gains taxes and corporate pension contributions cannot be calculated precisely, it appears that they presently depress the measured saving rate by somewhere in the 1 to 2 percent range. Adding in the change in the handling of mutual fund distributions brings the total of these direct stock market-related impacts to 2.5 to 3.5 percent.

FIGURE 1

THE PERSONAL SAVING RATE HAS DECLINED SHARPLY ACCORDING TO ALL STANDARD MEASURES



All of the saving concepts and measures we have examined so far have one clear pattern in common. After being relatively stable through the 1960s and 1970s, a declining trend emerged during the 1980s. In the 1990s the downturn intensified.

Other Measures Show A Declining Trend

Even if we were to adjust personal saving to the former treatment of mutual fund payments and to remove the direct impact of higher stock prices, the trend would still be downward, and the current saving rate would be low by historical standards. This conclusion is confirmed by the alternative data in the Flow of Funds (FOF) Accounts constructed by the Federal Reserve. Two types of FOF personal saving measures are available, and they are compared with the NIPA measure in Figure 1.

The way personal saving is measured in the FOF accounts is to track what is done with the funds that are not used for personal consumption expenditures. Such funds can be used to acquire financial assets or to invest in tangible assets (such as housing or consumer durables); because funds for such purposes can be obtained either by saving or borrowing, to isolate the portion that comes from saving, any net increase in liabilities must be deducted. Thus, FOF saving is computed as the sum of the net acquisition of financial assets and net investment in tangible assets less the change in liabilities; dividing by disposable personal income transforms the figures to a saving rate. The segment of the economy being measured here is households, (nonfarm) noncorporate business, and farm business; the latter two components would immediately make this measure different from the usual NIPA figure, which just covers households. Nevertheless, the trend is still very much the same in the two measures: The personal saving rate with both the NIPA and the FOF concepts and data show sharp decreases since the early 1980s, even though the latter figure has remained well

above zero (Figure 1). In 1998, the last full year for which data are available, the NIPA saving rate was 0.5 percent and the FOF measure was 6.2 percent.

As noted above, the segment of the economy is somewhat different in the two saving measures, but there is also a difference in concept. First, the FOF measure counts net investment in consumer durables as saving (or equivalently, treats only the economic depreciation in the stock as consumption), while the NIPA measure treats current outlays on durable goods as consumption (with no saving involved at all). The net investment in consumer durables can be removed from the FOF figure to make it comparable with the NIPA data. Second, one of the financial assets acquired in FOF is the insurance and pension reserves held for government employees; this is different from the treatment in the NIPAs and can also be removed. When corrections for consumer durables and government insurance/pension reserves (and a very small item for net saving by farm corporations) are made, the FOF data are converted to the NIPA concept of saving; a similar saving rate is then found by dividing by disposable personal income. With the same concept, but different data, the declining trend in the saving rate is very clear, and the two measures are quite close in recent years (Figure 1 again); the NIPA measure was 0.5 percent in 1998 while the FOF data using NIPA definitions came in at 1.3 percent.

All of the saving concepts and measures we have examined so far have one clear pattern in common. After being relatively stable through the 1960s and 1970s, a declining trend emerged during the 1980s. In the 1990s the downturn intensified and brought these saving-rate measures to very low—and even (in early 1999) negative—readings. The concepts and data differ somewhat, but the trend does not.

Most Explanations Seem Inadequate Or Incomplete

Many theories for the behavior of saving (or for consumption expenditures) have been proposed in the economics literature; the recent drop in saving has called forth a new round of search for explanations. Here is a partial listing:

1. High marginal tax rates on wages and salaries as well as on capital income discourage saving, while ample credit availability encourages spending. But little of this structure has changed recently, and the top capital gains tax rate was cut in 1998.
2. Life cycle theory explains saving behavior over an individual's lifetime. Applied to a country, it suggests more

saving as the population ages; in the U.S. the opposite has been occurring.

3. Behavior of cohorts within the age distribution has changed over time, and older Americans now spend much more relative to the young than they did in earlier periods; moreover, government programs such as Social Security and Medicare have transferred income to older groups. This is an interesting observation but does not provide much explanation.
4. The concept of Ricardian equivalence says individuals offset government decisions on saving. Recent government surpluses and declining personal saving seem to fit that mode, but when government deficits ballooned in the late 1980s-early 1990s there was no offsetting hike in personal saving.
5. Higher wealth has triggered more spending—what has been referred to as the Pigou effect in macroeconomic theory. No doubt, this factor has played a part in the recent saving decline, and we turn to it next.

Household Wealth Adds An Important Dimension

In assessing whether the household sector has become overextended, the saving rate provides one piece of useful information. But another important part of the story is conveyed by changes in the balance sheet.

Recent Wealth Increases Have Been Enormous

Of course, the rising stock market has received a great deal of attention in the past few years. The market value of the Wilshire 5000 has increased from \$3.4 trillion at the end of 1989 to \$11.3 trillion at the end of 1998, a 233.7 percent rise so far this decade. But to see what has happened to household wealth, we need to take into account other assets—financial and tangible—as well as liabilities. Fortunately, this can be done by using balance sheet figures supplied by the Federal Reserve.¹

Table 1 provides the principal entries from the balance sheet for the household sector at the end of 1998, as well as data for 1988 to show the change in the past decade. Unfortunately, the data include nonprofit organizations (such as foundations), and there is no way to remove them from the totals.

Net worth (line 21) has increased from \$18.4 trillion at the end of 1987 to \$36.8 trillion at the end of 1998, a doubling (or a rise of 100.1 percent using unrounded figures) that

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amounts to an annual growth rate of 7.2 percent.

If we put these figures on a per-capita basis, net worth rose from \$75,015 to \$136,117 during the ten-year period. The increase is 81.4 percent or 6.1 percent per annum; with the chain-weighted consumption price index up at an annual rate of 3.0 percent during the same time period, the advance is 3.1 percent per year in real terms. The distribution of this net worth across the public is skewed, to be sure, and it is still the case that a sizable portion of the U.S. population has few assets available for retirement. Those who own houses and stocks and have pensions have benefited disproportionately from the rising values of assets.

The increase in total net worth results from assets (line 1) rising by \$21.5 trillion or 100.1 percent, while liabilities increased by \$3.1 trillion (line 15) or 100.0 percent.

Financial assets rose by much more than did tangible assets; financial assets (line 5) rose by \$17.0 trillion (or 129.8 percent) while tangible assets (line 2)—mainly real estate and consumer durables—advanced by \$4.5 trillion (or 53.8 percent).

The stock-market rise and the allocation of new funds to stocks account for most of the boost in financial assets: If we add up the gains in corporate equities (up by 287.9 percent; line 8), mutual funds (up by 519.4 percent; line 9), pension fund reserves (up by 218.9 percent; line 11), and holdings of bank personal trusts (up by 174.5 percent; line 12), together they rose by \$13.5 trillion, which is 80.0 percent of the advance in financial assets. The latter three categories listed above include some assets besides equities, but the equity gains have been the dominant force.

Liabilities rose as well, dominated by mortgage debt that increased by \$2.1 trillion (or 101.8 percent; line 17) and consumer credit that increased by \$0.6 trillion (or 82.2 percent; line 18). But these advances were small in absolute magni-

tude compared with the asset increases, thereby contributing to the rapid gain in net worth.

Conventional Saving Pales Next To The Wealth Increases

It is useful to contrast the wealth changes with the previously discussed saving measures. The change in wealth from year to year is, in the public finance literature, an alternative definition of saving. In magnitude, the net worth rise dwarfs the NIPA saving total: The former is generally more than \$1 trillion (and has averaged \$1.8 trillion per year over the past decade), while the latter usually ran at \$100-\$250 billion dollars per year from 1989 to 1998 (until 1998 when it was less). If all of the saving is cumulated over the 1989-98 interval, the sum is \$1.79 trillion; in contrast, the net worth rise is \$18.4 trillion, as noted above. Several qualifications should be noted:

1. The conventional saving out of current income augmented the wealth numbers by flowing into various asset categories, both tangible and financial. But the advance in wealth was far greater, reflecting in addition the change in asset prices.
2. Remember, again, that the wealth statistics also include nonprofit corporations, whereas the NIPA saving data cover only private individuals.

The early 1999 rise of the stock market along with other economic signs suggest that the wealth increases are continuing.

National Saving Shows A Different Pattern

So far we have focused on the amount of personal saving in the United States—its measurement and interpretation.

This concept and the current readings might provide some insight into the prospective behavior of consumer demand, although the analysis presented above challenges the notion that there is any simple or immediate conclusion to be drawn: While the traditional saving rates are low, the increments to wealth have been enormous.

If we turn to the question about whether saving is adequate to finance investment, however, the personal saving situation is only one component of national saving; moreover, national saving² has been moving in the opposite direction from personal saving in recent years.

U.S. National Saving Has Been Rising—Gross Or Net

Saving, defined as the difference between current flow of income (or receipts) and current outlays, takes place in most of the economy's major sectors.

Gross saving includes depreciation (current flows that are used to replace capital that is wearing out) along with net new saving. This saving

TABLE 1

HOUSEHOLD NET WORTH HAS DOUBLED IN THE PAST DECADE *

	Percent Change		
	1988	1998	1988-1998
1. Total Assets (\$Bil.)**	\$21,508.0	\$43,036.7	100.1%
2. Tangible Assets	8,398.6	12,916.0	53.8
3. Real Estate ¹	6,712.6	10,202.2	52.0
4. Consumer Durables ²	1,641.4	2,629.6	60.2
5. Financial Assets	13,109.4	30,120.7	129.8
6. Deposits	3,052.2	4,089.1	34.0
7. Credit Market Instruments	1,232.2	1,737.7	41.0
8. Corporate Equities	1,619.0	6,279.8	287.9
9. Mutual Fund Shares	401.3	2,485.6	519.4
10. Life Insurance Reserves	335.7	707.0	110.6
11. Pension Fund Reserves	2,750.3	8,770.1	218.9
12. Investments In Bank Personal Trusts	470.3	1,291.0	174.5
13. Equity in Noncorporate Business	3,016.2	4,164.4	38.1
14. Miscellaneous	191.3	321.9	68.3
15. Liabilities	3,124.9	6,250.1	100.0
16. Credit Market Instruments	3,024.3	5,958.3	97.0
17. Home Mortgages	2,034.6	4,106.1	101.8
18. Consumer Credit	732.0	1,331.6	82.2
19. Other Loans, Etc.	257.8	518.7	101.2
20. Other	100.5	291.9	190.4
21. Net Worth	18,383.2	36,786.6	100.0
22. Net Worth Per Capita (\$)***	\$75,015	\$136,117	81.4

Note: *Data include households and nonprofit organizations. **Some small subcategories not shown separately, but are included in the total. ***Based upon U.S. Population of 245.0 million in 1988, 267.9 million in 1997, and 270.3 million in 1998.

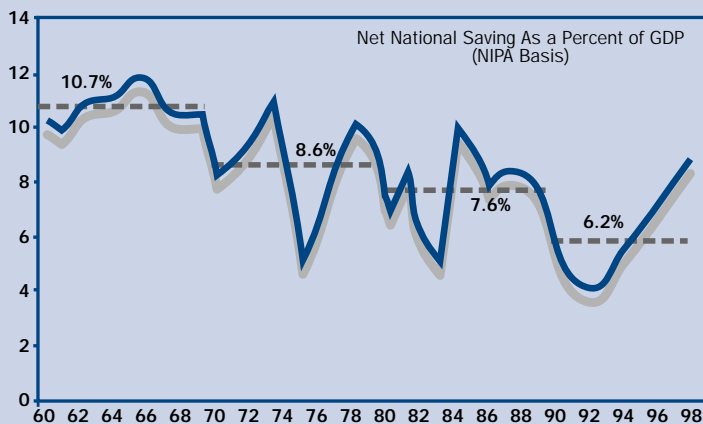
¹Market Value.

²Replacement-cost estimated.

Source: Federal Reserve Board

FIGURE 2

ALTHOUGH LOW ON AVERAGE IN THE 1990S, THE NATIONAL SAVING RATE HAS RISEN SHARPLY IN THE PAST SIX YEARS



Note: Dashed lines are decade averages.

takes place in a number of sectors—personal saving (as discussed earlier), corporate saving (depreciation plus retained earnings), noncorporate depreciation, the federal budget balance, the balance of all state and local budgets, and inflows (or outflows) of funds from overseas that finance the current account balance. When all of these components and a few small accounting items (including statistical discrepancy) are combined, the total gross saving recorded in the U.S. economy for 1998 was \$1,680.6 billion, or 19.7 percent of GDP; this reading is a significant step-up from the low of 15.3 percent reached in 1992.

A conceptually more important saving concept is net national saving, the unconsumed resources available each year to add to the country's capital stock—above and beyond the funds that are needed to replace the assets that are wearing out. All of the sectors listed above contribute to the net saving, minus the depreciation entries at the corporate, private noncorporate, and governmental entities.

The amount of net saving is, of course, smaller than gross saving, but the trend has recently turned positive: The data along with the decade averages in Figure 3 show the pattern. Net saving in the 1990s (1990-98) has averaged only 6.2 percent of GDP versus 7.6 percent in the 1980s, 8.6 percent in the 1970s, and 10.7 percent in the 1960s. Gross saving figures show a similar pattern, but because depreciation has risen over time, as asset lives have shortened on average, there is less deterioration present there. Indeed, because estimates of depreciation (capital consumption) are fraught

with measurement difficulties, we should monitor the gross saving results along with those on the net basis, in spite of preferring the latter on conceptual grounds.

Although the record for the 1990s in total has been poor, the past few years have seen a distinct upturn (Figure 2 again). The 9.1 percent of 1998 is above the 8.3 percent average for the entire 1960-98 time period, is the highest in thirteen years, and from the low point of 3.9 percent in 1992 the latest reading constitutes more than a doubling. This has occurred, of course, while the personal saving rate has collapsed, according to the NIPA and FOF measurements.

The Shift In The Federal Budget Has Been Critical

What accounts for the advance in net national saving while personal saving has fallen? All of the other components have seen a pickup (Table 2). We illustrate the gains by comparing each component from the year when total net national saving reached its low (of 3.9 percent in 1992) with the 1998 result.

1. On the negative side, of course, personal saving fell from 3.9 percent of GDP to 0.3 percent during the 1992-98 period.³
2. Corporate saving—remember that, on the net basis, this is retained earnings—rose from 2.2 percent of GDP to 3.6 percent, as corporate profits increased sharply.
3. The government sector had the biggest gain, moving from a deficit that was equal to 3.1 percent of GDP in 1992 to a surplus of 2.6 percent—a net swing of 5.7 percent of GDP. The primary factor behind the shift is what happened at the federal level, where a deficit equal to 4.5 percent of GDP in 1992 turned into a surplus of 0.9 percent in 1998.
4. As the current account deficit has risen, net foreign saving has advanced—from 0.8 percent to 2.5 percent of GDP.

So the overall saving pattern for the United States looks very different from that in the personal saving data. The fall in the latter has been more than offset by the shift in the federal budget, by higher corporate saving, and by the increased inflow of foreign funds. The well-documented boom in investment spending in the United States during the 1990s is

another sign that total saving has been moving upward.

An International Comparison

Up to this point, this article has focused on domestic saving patterns in isolation. How do U.S. results look when compared with other advanced countries? Generally in the past when such analyses were prepared, the United States has come out looking as a low saving nation, but a variety of adjustments prepared and discussed by Kirova and Lipsey⁴ changes this story significantly. Because of data availability and comparability problems across countries, the analysis must be done with gross saving (as a share of GDP), and the available data have been compiled only through 1994. In addition, much of the information is tabulated for investment and not for saving. But exploiting the identity that saving equals investment, any adjustments that are made to investment to convert it into real terms and to include omitted items also would apply to saving.

Conventional Comparisons Show the United States Lagging Other Industrial Nations

Using data compiled by the Organization for Economic Co-Operation and Development (OECD), the United States' gross investment outlays were 18.8 percent of nominal GDP in the period 1970-74, rose to 19.3 percent in the next two five-year intervals, but then declined during the next ten years, reaching 16.3 percent in the 1990-94 period. For the twelve other industrial countries used in the comparison, the ratio also declined in the recent period, to 19.7 percent from a high of 25.0 percent in 1970-74 (Figure 3). The U.S. ratio stated as a portion of that in the twelve other OECD countries has varied from a low of 75.3 percent in 1970-74 to a high of 90.6 percent in 1980-84, and was 83.2 percent in the most recent period for which data are available. The main point to notice is that, while there has been some variation over the past twenty-five years, the United States consistently has invested (and saved) a smaller portion of its GDP than have other industrialized countries. How serious this shortfall is can, of course, be debated, but at face value the figures seem

TABLE 2

NET NATIONAL SAVING HAS RISEN AS THE GOVERNMENT, CORPORATE, AND NET FOREIGN COMPONENTS HAVE ADVANCED (Percent of Gross Domestic Product)

Period	Total National Saving	Personal	Corporate	Total	Federal	State and Local	Foreign
1960-1998	8.3%	4.7%	2.9%	0.2f&	-1.8%	1.9%	0.5%
1960-1969 (Average)	10.7	5.2	3.6	2.5	0.4	2.1	-0.6
1970-1979 (Average)	8.6	5.8	2.8	0.2	-1.9	2.1	-0.2
1980-1989 (Average)	7.6	5.0	2.2	-1.3	-3.2	1.9	1.6
1990-1998 (Average)	6.2	2.7	2.9	-0.8	-2.3	1.5	1.4
1990	5.8	3.7	2.0	-1.3	-2.7	1.4	1.4
1991	4.2	4.1	2.2	-2.0	-3.3	1.3	-0.1
1992	3.9	4.2	2.2	-3.1	-4.5	1.4	0.8
1993	4.6	3.2	2.6	-2.5	-3.8	1.3	1.2
1994	6.1	2.5	2.9	-1.3	-2.7	1.4	1.7
1995	6.7	2.5	3.5	-0.9	-2.4	1.5	1.4
1996	7.3	2.1	3.4	0.2	-1.4	1.6	1.6
1997	8.3	1.5	3.7	1.4	-0.3	1.7	1.7
1998	9.1	0.3	3.6	2.6	0.9	1.8	2.5

Note: Details may not sum to total due to rounding, and the small additional entry, wage accruals less disbursement.

Source: Bureau of Economic Analysis, U.S. Department of Commerce, *Survey of Current Business*, April 1999.

to depict a relatively poor outcome.

Adjusted For Capital Goods Price Differentials, The Comparison Is Better

What should matter for economic performance is the amount of real capital that is put in place, not the nominal expenditures. If a country has relatively low capital goods prices compared with the prices of other goods and services, then it may be possible to put more new capital in place for a given amount of nominal outlays than can be done elsewhere in the world.

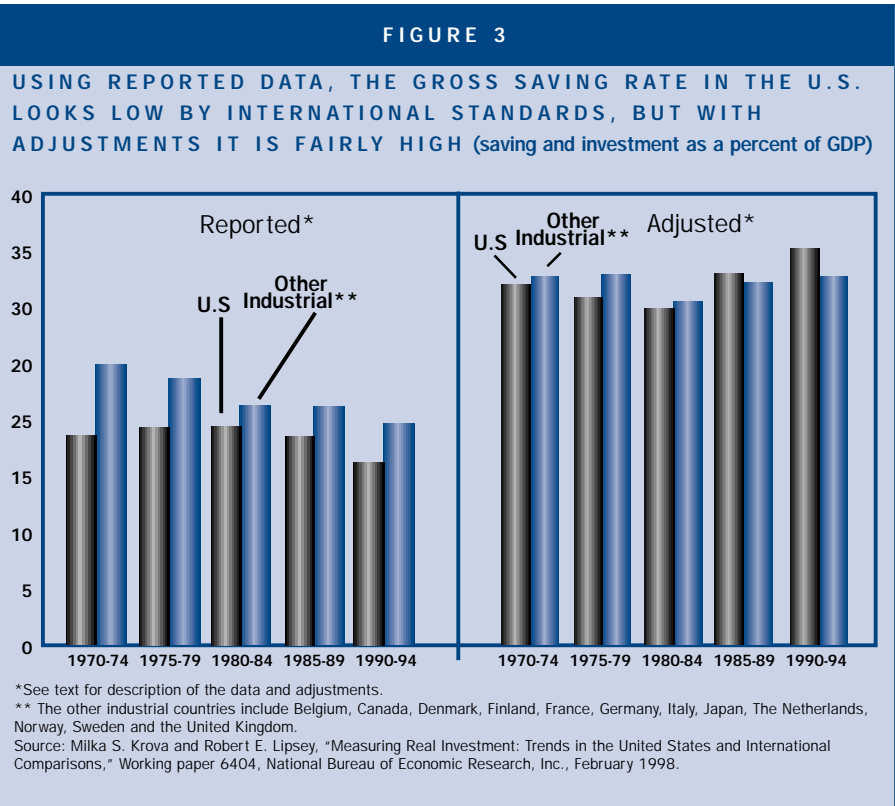
That in fact appears to be the case in the United States. While there has been some variation over the period 1970-94, prices of capital goods have fallen markedly relative to other prices in the United States since the start of the 1980s, and while other industrialized countries have the same trend, the data suggest it is much more pronounced here. Kirova and Lipsey observe that this makes sense in light of the comparative advantage the United States enjoys in international trade in capital goods. Note also that the domination of high-technology items in capital goods here—with their declining absolute prices, especially for computers—also lends some credence to this proposition.

Omitted Investment Outlays Change The Picture Further

What is counted as investment and saving is the subject of considerable controversy; in many respects the way they are treated in the NIPAs is arbitrary, although certainly useful for many purposes. Kirova and Lipsey argue for inclusion of the following items in investment with the funds so allocated also representing saving.

1. Consumer purchases of durables render services over a period of years, in a fashion similar to business capital goods. Thus expenditures for them should be added to the investment (and saving) totals. This is the same issue encountered earlier in the FOF definition of personal saving.
2. The United States expends a large quantity of funds on education, the benefits of which, by boosting human capital, occur over long periods of time; this also should be treated as saving and investment.
3. Research and development outlays of the private and public sectors are undertaken to develop intellectual capital.
4. Military capital outlays cover items that last for extended periods of time and render services over comparable periods. Some would argue that they do not contribute to GDP in the same way as private outlays do. Yet technological spillovers from endeavors such as the missile and space programs can be cited as justification for their inclusion. Remember also that consumption is sacrificed to undertake these outlays, just as it is for private investment.

Upon inclusion of all the adjustments—for the difference in the relative price of capital goods among the countries as well as for unconventional investment outlays—the United States is no longer below the readings for the average of the twelve other countries. Indeed, since 1985 the fully adjusted ratio for the United States exceeds that for the twelve other OECD nations (Figure 3 again). The same conclusion for investment applies to the saving pattern.



New Data And Computer Software Would Raise The U.S. Standing Further

Unfortunately the complete data (on a consistent basis) to make these international comparisons are available only through 1994. But it is probable that the U.S. position would look even better with more recent figures. That is because gross and net national saving for the United States have increased in recent years, as discussed earlier. At the same time poor economic performance overseas (especially in Japan, but even to some degree in Europe) has restrained saving and investment in those regions.

Another factor would boost the U.S. position even further—the inclusion of computer software. Unless it comes installed with the hardware, software is generally expensed, hence not counted in investment. But software usually generates services for several years and should be treated as a capital item. This country spends large amounts on software development.

Policy Implications Of The Saving Situation

The analysis in the previous sections points to several favorable conclusions:

1. While subject to numerous measurement errors, the decline in the personal saving rate is corroborated by all of the standard measures.
2. But the low saving rate does not imply financial distress in the household sector, because there have been tremendous increases in wealth (i.e., net worth).
3. National saving has been rising, and it is now back to above-average levels. While personal saving has fallen, there have been massive improvements in the federal budget along with gains in other sectors.
4. International comparisons, adjusted for prices and unconventional forms of saving and investment, show the United States to be doing comparatively well.

This Is No Time For Complacency

In light of these findings, should we be completely sanguine about the saving picture? That would be ill-advised for several reasons.

1. The projected federal budget surpluses, which are playing a central role in boosting national saving, may not last long, given political pressures for spending increases and tax cuts.
2. The country has unmet funding needs in major social programs, such as Social Security and Medicare.
3. The rise in inflows of foreign saving to finance the enlarged current account deficit cannot be sustained over the long run.

Fortunately, there is a way to deal with these issues in a systematic fashion.

There is considerable discussion today about reforming Social Security due to the eventual exhaustion of the trust fund under current policies. The current surplus in the federal budget could be used to fund a system of private accounts that would be invested in stocks and bonds.⁵ This action would, over the long run, raise the returns on funds going into the Social Security system.

But such action would also shift saving from the government sector to households, thereby insulating the funds from political pressure. Another similar step would be to provide a mechanism for individuals to accumulate funds to cover future healthcare costs. Here as well, such action would augment national saving and help deal with the looming exhaustion of the Medicare trust fund. Other actions, such as relaxing some of the restrictions on 401k accounts and IRAs, would also encourage saving. ■

FOOTNOTES

¹They are included in the Federal Reserve Boards' *Flow Of Funds Accounts For The United States*.

²The term "national saving" is used here to mean the total saving available within the United States and to distinguish this concept from the "personal saving" portion. In the NIPAs, the saving and investment accounts use the terms "gross saving" and "gross investment," which can be converted to "net saving" and "net investment" by deducting consumption of fixed capital (i.e., economic depreciation). I have used these figures but with one difference: Net foreign investment, the current account balance (presently a deficit) in the NIPAs, is deducted from the sum of private and government investment. But I have moved it to the saving side of the identity, where it represents the inflow of capital from overseas that finances the current account deficit.

³Note that in Figure 4, personal saving is stated as a share of GDP to be comparable with the saving rates in other sectors. In the earlier discussion, the personal saving rate was defined as saving divided by disposable income, because that is the conventional measure when focusing on the household sector alone.

⁴See the article by Kirova and Lipsey listed in the references below for the details behind the numerical calculations.

⁵One such proposal was set forth by Martin Feldstein. It would allow individuals to open a personal retirement account and claim a tax credit equal to as much as 2 percent of the Social Security wage base.

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