

Is Increasing Wealth a Substitute for Saving?

Social Security, consumption tax, economic growth, trade deficits and an ant. What do these things have in common? All are related to saving or lack of it. Jokes about one-armed economists notwithstanding, there is a surprising amount of consensus among economists about the need for a higher saving rate for the U.S. economy.

Economists worry about low saving rates because saving is critical to the rate of capital accumulation which, in turn, is related to economic growth, labor productivity and standard of living. A higher saving rate implies more capital formation, higher labor productivity, and usually a higher standard of living. So a low saving rate means less capital or increased borrowing from other nations.

Personal saving as a percent of disposable personal income (see p. 13)—the most widely quoted measure of saving—has been falling steadily since the early 1980s, and recent estimates suggest that we saved less than 4 percent of our disposable income in 1997. A related measure of saving—total private saving—shows a similar trend (see p. 15).

Unfortunately, the standard measure of personal saving, as defined by national income accounting rules, does not reflect the changes in the value of households' assets. The problem is particularly salient now given the recent performance of the U.S. stock market. Between 1980 and 1996—the period of decline in the personal saving rate—the S&P 500 index rose more than 500 percent. Such increases in wealth imply that, in addition to any accumulation of new assets,

markets believe that existing assets will be more productive in the future, so the increased wealth may substitute for capital accumulation.

Nevertheless, the broader concept of saving does not alter our view of the recent trend in saving. The chart shows the personal saving rate and another measure using changes in U.S. households' net wealth from the Flow of Funds, also as a percent of disposable personal income. The data indicate that the second measure of saving is much higher than the conventional measure and much more volatile. Neither conclusion is surprising given the size of year-to-year fluctuations in asset prices. More importantly, the alternative measure also shows a declining saving rate since the early 1980s, despite rising stock prices.

—Peter Yoo

