RCS
RETIREMENT CONFIDENCE SURVEY®

THE SAVINGS PARADOX?

***Question*:**
If more and more people are saving for retirement, how can the personal saving rate be near zero in the United States today?

Answer:
First it's necessary to understand how the "personal saving rate" is measured. The most frequently cited definition comes from the Bureau of Economic Analysis of the U.S. Department of Commerce, based on the National Income and Product Accounts (NIPA). As measured by NIPA, the U.S. savings rate for 1998 was 0.5 percent of disposable personal income (see below).[1]

Under NIPA, personal savings is a *residual*. This means that personal savings is what is *left over* from personal income after subtracting payments for personal taxes, individual contributions to social insurance (i.e., payroll taxes for Social Security and Medicare), and personal outlays such as food, housing, and clothing.

Personal income includes the following:
- Wages and salaries.
- Other labor income (i.e., employer contributions to pensions and profit-sharing plans and group insurance, such as health, workers' compensation, and supplemental unemployment).
- Rental income.
- Personal dividend income.
- Personal interest income.
- Transfer payments to persons (i.e., Social Security, government unemployment and insurance payments, veterans benefits, government employees retirement benefits, and welfare payments).

Personal taxes include the following:
- Federal income tax payments.
- State and local income tax payments.
- Any penalties, fines, or interest payments made on income tax statements.

Personal outlays include the following:
- Personal consumption expenditures (i.e., spending on food, housing, clothing, household operations such as utility bills, transportation, and medical care).
- Consumer interest payments (i.e., payments of credit card interest).
- Personal transfer payments to foreigners.

Personal savings is what is left over from personal income after deducting the above outlays, contributions to social insurance, and taxes. Personal savings divided by *disposable personal income* is the personal savings rate. Disposable personal income equals personal income *after* deducting personal taxes and individual contributions to social insurance, but *before* personal outlays are deducted. So on the surface, a zero personal saving rate on the national level would *appear* to mean that individuals are consuming all of their income in a given time period, but….

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[1] A less-quoted measurement of personal savings is the Flow of Funds Accounts (FFA) produced by the Federal Reserve System, which differs from NIPA in its definition of personal income and consumer durables. For instance, the FFA treats the acquisition of consumer durables (i.e., automobiles, major household appliances, etc.) as a form of saving, whereas NIPA treats consumer durables expenditures as personal consumption. FFA consistently shows a higher national savings rate than NIPA, but receives less attention in the news media.

Income, as measured by NIPA, only includes wages, dividends, interest, and rental income; it does NOT include capital gains on stocks and other assets.

So what does that mean? Individuals who own equities have generally experienced tremendous increases in the value of those financial assets over recent years; i.e., they are wealthier. According to federal data, the net worth of U.S. households[2] increased from $16.8 trillion at year-end 1987 to $33.2 trillion at year-end 1997, as assets increased by $19.4 trillion and liabilities increased by $2.9 trillion. Of this asset increase, $15.0 trillion came from financial assets and $4.4 trillion from tangible assets (such as real estate). In other words, 77 percent of the increase in net worth over the past 10 years was due to the stock market rise.[3]

If individuals choose to spend more as a result of this increased wealth, such behavior would drive down traditional measures of personal savings. This is so because under NIPA, the increase in wealth does not show up as income, but the increased consumption that some of it finances does figure into the savings rate calculation.

So it is quite possible to have households saving money for retirement—say through a 401(k) plan or an individual retirement account (IRA)—while simultaneously tapping into recent wealth gains to fund additional consumption.

One could argue that a more complete measure of saving would include increased wealth through capital gains as part of personal income. According to one estimate,[4] if the value of capital gains were included in income when measuring savings, the 1997 savings rate would have been 8 percent, as opposed to the NIPA estimate of 0.8 percent.

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[2] Including nonprofit organizations, which cannot be segregated from the data.

[3] Richard D. Rippe, Rita J. Lavin, and Philip Laverson, "There Is No Saving Crisis," *Prudential Securities Economic Outlook Monthly* (January 1999).

[4] Klaus Friedrich, "The Real American Savings Rate," *New York Times,* May 4, 1999.