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NOTE: New Schedule.
Starting with this issue, *Economic Review* will be published every other month.

Do We Save Enough?

The government statisticians reported that personal savings were *negative* for the past two years. If that wasn't enough, the media went on to point out that this last happened during the Great Depression. However, a recent *Wall Street Journal* article said the official savings rate was close to "useless."

A lot of the confusion and controversy over the savings rate has to do with the difference between looking at savings from an individual family's *micro* point of view vs. the vantage point of the *macro* economy. The national savings rate was never intended to measure whether families have set enough aside for retirement. Rather, it is part of a broader effort to gauge how well we live within our means as a nation. Got that, *Wall Street Journal*?

Let's start with the "official" definition of macroeconomic savings. Simply stated, personal savings equal disposable (after-tax) income minus consumer spending. Savings are what's left over.

Some people get really bothered by the fact that this definition includes income (wages, salaries, dividends, interest) but excludes capital gains, such as those from appreciating houses or rising stock prices.

Why exclude capital? Consumers spend their capital gains all the time by selling their stocks and tapping the wealth in their homes through mortgage re-financings and home equity loans. One of the principal ways that families have been able to spend more than they earn is by "monetizing" the appreciation of their homes.

The reason why capital gains are not included is *macro*economic. If we don't *consume* all of our current production, then what remains of that Gross Domestic Product can be used for *investment* in new structures, equipment and technologies.

Some complain that the official savings measure doesn't include 401ks. That's not true. Suppose you have a payroll deduction plan at work that sets aside a certain amount from your paycheck each week. This would be savings because you are not consuming that portion of your income. But if you moved money from under your mattress or from a checking account to fund the 401k, it would not count as new savings.

Economy-wide savings include much more than the household or personal sector, as the table shows. Savings by corporations take the form of retained earnings. Also called undistributed profits, this is what is left over after companies pay all the bills and dividends. And for the government sector, savings are measured in terms of the budget surplus or deficit (receipts minus expenditures).

As individuals, if we spend less than we earn, we have something left over as per Dickens' Macawber. If we spend more, then we either have to borrow to cover the shortfall or sell (pawn) assets. As a nation, spending more than we *earn* means spending more than we *produce*. Not only do we have to import the shortfall of goods, but must finance this by

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Musings & Amusings

Errol Flynn:
"My problem lies in reconciling my gross habits with my net income."

ee cummings:
"I'm living so far beyond my income that we may almost be said to be living apart."

Wilkins Macawber of *David Copperfield*:
"Annual income twenty pounds, annual expenditure nineteen six, result happiness. Annual income twenty pounds, annual expenditure twenty pounds ought and six, result misery."

borrowing from foreigners or selling them our assets. Focusing on income and excluding capital gains enable us to calculate how much we have to borrow or hock to finance our lifestyles.

U.S. SAVINGS (BILLION $)*

	2000	2004	2005	2006*
TOTAL	582	108	7	258
PERSONAL	169	174	-35	-91
CORPORATE**	175	328	354	498
FEDERAL	189	-382	-309	-159
STATE & LOCAL	50	-13	-3	10
ADDENDUM:				
CURRENT ACCOUNT	-415	-665	-791	-875

SOURCE: BUREAU OF ECONOMIC ANALYSIS. *1ST 3 QUARTERS
**RETAINED EARNINGS

Between 2000 and 2006, total savings plummeted. The federal government is much more to blame than those free-spending households as the budget swung from surplus to deficit. In order to finance all this spending by households and government, we had to borrow about $875 billion from foreigners last year!

In other words, our biggest import is the savings supplied by foreigners! And we keep piling debt on top of debt. The $875 billion (also known as the *current account deficit*) is the new money borrowed in 2006. It has to be added to the more than $3 trillion we already owed them at the end of 2005 over and above what they owed us.

The economists who worry about these sorts of things like to remind us that we have to service this growing debt and eventually pay it back. We have borrowed to finance consumer purchases, new homes, office buildings, factory equipment, even tax cuts and national defense. However, the burden of repaying these borrowings has been shifted to future generations. The adjustment could be painful. It may take a substantial drop in the foreign exchange value of the U.S. dollar to curb our appetite for imported savings. This might erode U.S. living standards, or at least reduce the rate of increase.

I didn't mean to sound so morose! There is definitely some good news. Last year, U.S. exports grew more rapidly than imports for the first time in a long while. This should help keep our foreign borrowing needs from growing but won't eliminate them anytime soon. With the level of imports twice as large as exports, it would take a long time for the faster rise of exports to erase the trade deficit, which represents most of the current account deficit. (For the mathematically minded, suppose the dollar value of imports is twice as large as exports. If exports grow twice as fast as imports, the dollar size of the trade deficit won't change. Honest! Try some numbers.)

And despite the further drop in personal savings last year, total savings rose thanks to smaller budget deficits and stronger corporate profits. Nonetheless, we had to borrow more from foreigners to finance the rapid growth of U. S. spending.

Moving to the micro level: has the typical family set enough aside for retirement? The answer requires major assumptions and highly individual calculations. Unlike the national savings rate, this computation should appropriately take into account the appreciating value of homes and equities.

Asset appreciation is included in calculations of household net worth made by the Federal Reserve. Net worth has been rising thanks in large part to the stock market. Maybe this will help clarify: your net worth will increase as a result of (1) what you set aside as savings from your income and (2) the increase in the value of your assets.

I personally think folks need to add an extra margin of safety these days. We're living longer, which is good but costly. No one can say for sure how lush or lean the future benefits from Social Security and Medicare will be. I'll bet that part of the solution to putting the Social Security program on a sounder financial footing will be to reduce the growth of benefits below what is provided by current law. Nursing home care, which is not covered by Medicare, is very expensive. Nobody knows when house prices will start rising again or even whether they've stopped falling.

In addition, very safe investments, such as U.S. Treasury bonds, have relatively low yields these days. For example, interest on the 10-year U.S. Treasury note has been running about 4 1/2% lately. Most surveys suggest a long-term inflation (CPI) outlook of around 2 1/2% per year. This leaves a "real" bond yield of roughly 2%. Over the past 20 years, the actual real yield has been closer to 3% (6% for the Treasury note minus 3% average annual CPI rise). While this difference may not seem like much, it has a big impact on retirement incomes when compounded over time. Low interest rates are usually viewed as a good thing, but they do make it more difficult for your money to grow. I guess every silver lining has a cloud outside or something like that.

Further, family decisions about the income needed for retirement also take into account individual goals as to what kind of estate they'd like to leave behind for their children, favorite charities, etc.

So, do we save enough? At the level of the household, that is best answered by you and your needs and goals. However, at the macroeconomic level, the answer is an unambiguous NO! As a nation, we're still borrowing huge amounts from foreigners to finance our consumption, investment and government.

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