

## A Look Behind the Savings Rate

The widely followed personal savings rate recently decreased to a 33-year low. This has led many critics to assert that the "Reagan tax cuts" failed to increase incentives to save and invest. The personal savings rate is based on a residual estimate that does not even attempt to determine what people actually have done with their money. The Flow of Funds accounts, which measure changes in holdings, suggest that individuals actually may have increased their willingness to defer current consumption since the 1981 Tax Act was passed.

However all estimates of savings and capital formation are based on arbitrary accounting allocations, not only among sectors of the economy but also between outlays that are currently consumed and items that will be used in the future. For example, most savings estimates include homes but exclude roads. But even if an indisputable measure of capital formation were devised, it would be only part of the story. What is set aside for the future may not be useful; i.e., the rate of return on capital is as important as its amount. The degree to which resources are allocated by the marketplace, rather than by central planners and regulators, is as important as incentives to save and invest.

Again and again we are informed that declining U.S. industries need to be replaced or upgraded to be competitive

in world markets, that the U.S. infrastructure is crumbling, or simply that we must encourage capital if the United States is to remain a capitalist nation. Few who pronounce on this subject seem to have a clear understanding of savings, investment, how they actually are measured, or what such measurements signify.

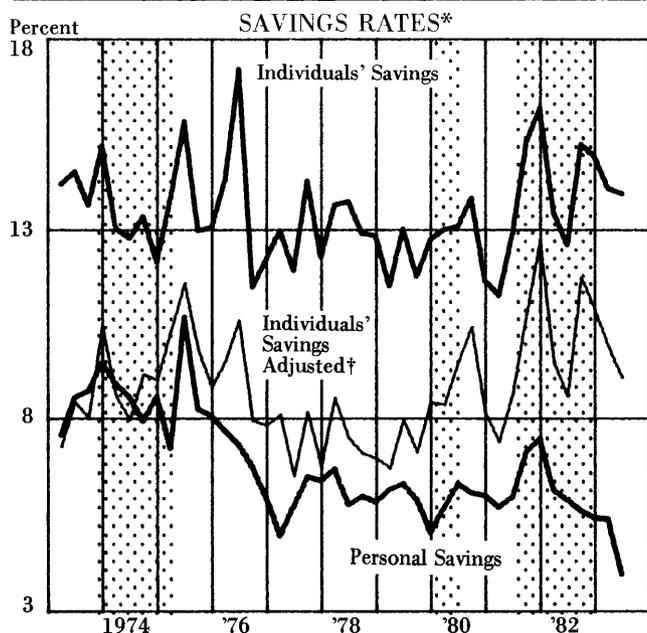
The "personal savings rate" is the most often cited savings statistic. This series, which is derived from the National Income and Product Accounts (NIPA), is the amount of "personal savings" expressed as a percent of the amount of "disposable (after tax) personal income." The personal savings rate averaged 7.0 percent during the 25 years ended 1976, and 6.0 percent in the years 1977-80. It increased slightly during the second half of 1981, but it then decreased to a 33-year low of 4.0 percent in the second quarter of 1983. This decrease has been offered as evidence of the failure of "Reaganomics," because one of the promised effects of the 1981 Tax Act was to increase saving and investing.

But before leaping to such a conclusion, let us consider what specific savings or investing vehicles are used in the estimate of personal savings. The surprising answer: none. The NIPA estimate of personal savings is not comprised of so much in savings accounts, so much in corporate bonds, so much in T-bills, etc. It is simply a *residual*: what is left from the estimate of personal income after deductions for taxes, consumption outlays, interest payments, etc. In 1982 this residual estimate was \$125 billion, as shown in line I. a., under the column "Individuals" of the accompanying table.\* Readers may note that this \$125 billion of "personal savings" is larger than net savings for the whole economy (\$55 billion, line I. a., "Total" column) but only a fraction of gross savings (\$415 billion, line I. c., "Total"). As we shall describe, none of these amounts is especially pertinent to what advocates of capital formation seem to be considering. But, for the moment, we will continue to focus on individuals.

### What People Actually Did With Their Money

The Flow of Funds accounts measure changes in holdings of financial assets. As the table shows, individuals acquired \$366 billion of financial assets during 1982 (II. a.) and borrowed \$128 billion (II. b.), so that their "net financial investment" then was \$238 billion (II. c. and IV. a.). Add \$417 billion of tangible assets purchased less \$349 billion of estimated depreciation of tangible assets acquired in the past or "capital consumption allowances" (IV. b.) and the estimate of what individuals set aside for the future becomes \$305 billion (IV. d.). This is \$180 billion more

\* We will discuss the 1982 data in detail rather than those for more recent quarters because the quarterly data are subject to erratic fluctuations and revisions. The 1982 personal savings rate was 5.8 percent (\$125 billion personal savings divided by \$2,176.5 billion disposable personal income.



\* Estimated savings as a percent of disposable personal incomes.  
 † Individuals' savings from the Flow of Funds estimates adjusted to conform to the definition of personal savings in the National Income and Product Accounts.

MEASURES OF SAVING IN 1982  
(Billions of Dollars)

I. Nat'l Income & Product Acc'ts (NIPA)	Indi- viduals*	Corporations		Governments		Rest of the World	Discrepancies	Total
		Nonfinancial	Financial	Federal	State & Local			
a. Net savings (NIPA basis)	\$125	\$38	-\$1	-\$147	\$31	\$8	\$1	\$55
b. Plus: capital consumption allowances	140	207	12	—	—	—	—	359
c. Gross Savings	\$265	\$245	\$11	-\$147	\$31	\$8	\$1	\$415
II. Flow of Funds Accounts (F. of F.)								
a. Net funds supplied	\$366	\$20	\$408	\$21	\$28	\$2	—	\$844
b. Less: Net funds raised	-128	-68	-407	-177	-37	-32	4	-844
c. Net Financial Investment	\$238	-\$48	\$1	-\$155	-\$9	-\$30	\$4	-0-
III. Tangible Investment								
a. Durable goods	\$298	\$143	\$10	\$53	\$13	—	—	\$516
b. New structures: 1. Residential	85	3	—	—	2	—	—	90
2. Other	38	101	7	11	36	—	—	192
c. Change in business inventories	-3	-21	—	—	—	—	—	-25
d. Total Physical Investment	\$417	\$225	\$17	\$63	\$52	—	—	\$774
e. Less: 1. Military purchases	—	—	—	-53	—	—	—	-53
2. Other government purchases	—	—	—	-10	-52	—	—	-62
f. Tangible Investment (IV. b., below)	\$417	\$225	\$17	-0-	-0-	—	—	\$659
g. Less: Consumer durables	-245	—	—	—	—	—	—	-245
h. Gross Private Domestic Investment	\$172	\$225	\$17	—	—	—	—	\$415
IV. Flow of Funds Savings Calculation:								
a. Net financial investment (II. c., above)	\$238	-\$48	\$1	-\$155	-\$9	-\$30	\$4	-0-
b. Plus: Tangible investment (III. f., above)	417	225	17	—	—	—	—	659
c. Less: Capital consumption allowances	-349	-207	-12	—	—	—	—	-568
d. Net Saving (F. of F. Basis)	\$305	-\$31	\$6	-\$155	-\$9	-\$30	\$4	\$91
e. Adjustments: 1. Net consumer durables	-35	—	—	—	—	—	—	-35
2. Sector definitions	-48	11	-2	4	35	—	—	—
f. F. of F. Saving Adjusted to NIPA Basis	\$222	-\$20	\$4	-\$151	\$26	-\$30	\$4	\$55
g. Difference†	\$97	-\$58	\$5	-\$4	-\$5	-\$39	\$4	-0-

\* Includes farms and noncorporate businesses. † Adjusted Flow of Funds savings less NIPA savings. Source: National Income and Product Accounts (Department of Commerce) and Flow of Funds Accounts (Federal Reserve Board). Totals may not add due to rounding.

than the \$125 billion residual estimate of personal savings from the NIPA.

Part (\$35 billion, IV. g.) of this \$180 billion difference is explained by the fact that the Flow of Funds considers consumer durables as investments for the future, while the NIPA does not. Also, the two accountings have somewhat different sector definitions. With respect to individuals, the major portion of the \$48 billion (IV. e. 2.) difference due to sector definitions is that the Flow of Funds considers government pension fund assets as belonging to individuals (i.e., a part of their savings), while the NIPA does not.

Even after adjustments of the Flow of Funds estimate of individuals' savings to conform to that in the NIPA, there remained a discrepancy of \$97 billion in 1982 (IV. g.). These three series, each expressed as a percent of disposable personal income, are shown in the accompanying chart. As the chart shows, the trend of individuals' savings measured by the Flow of Funds Account, both before and after adjustment, has been upward recently. Perhaps, the U.S. public did respond to the 1981 Tax Act's incentives by saving and investing more.†

It may be noted that the "Total" column of line IV. g. is zero. The differences in the three estimates of savings

rates shown in the chart entirely reflect allocations for accounting purposes; the totals for net savings (\$55 IV. a. and IV. f.) and gross private domestic investment (\$415 billion, III. h.) are the same for both the NIPA estimate and the Flow of Funds. They are in fact the same data. Except for a small discrepancy, net financial investment for the whole economy is zero (for every lender there is a borrower), and the Flow of Funds savings estimate incorporates the NIPA estimates of tangible investments.

#### Arbitrary Accounting Allocations

That the Federal Reserve considers consumer durables as a form of savings, while the Department of Commerce does not, suggests that estimates of savings (which by any accounting must total estimated investment) are dependent on what portion of a given period's outlays are deemed to be useful in the future and how much of prior period outlays are used up in a given period. These judgments must be made by accountants to produce the estimates; but they are arbitrary.

Section III of the table, "Tangible Investment," shows the tangible items that might have been included in the estimate of capital formation in 1982. We have shown several items that most analysts of savings and investment do not. These include government purchases of durable goods and structures and consumer purchases of durables. It should be stressed again that any estimate of savings is ultimately derived from an allocation of current outlays into items that will be useful in the future and those "consumed" in the present accounting period. Moreover, estimates of net savings can be derived only after an estimate of capital consumption (wear and tear, obsolescence, etc.) is deducted. All of these accounting allocations are perforce arbitrary.

† The Flow of Funds estimate presumably more accurately reflects the degree to which individuals are willing to forego current consumption in favor of future consumption. Unlike the NIPA estimate of personal savings, which as a residual includes any and all errors in the measurement of other components of national income, the Flow of Funds attempts to measure what individuals actually acquired for use in the future. In any event, the chart shows clearly that the discrepancy between the two estimates has widened during the past decade. The \$97 billion discrepancy in the individuals' sector is mainly offset by the discrepancies for nonfinancial corporations and foreigners. Sales of assets (which the NIPA does not measure) could account for much of this.

For example, residential construction is one of the largest components of gross private domestic investment (and therefore of both net and gross savings, as measured). Few would argue that more houses would somehow make us more competitive producers *vis-a-vis*, say, Japan. By the same token, governments do build some things, such as streets, highways, bridges, airports and docks, that make the United States more productive and would be included in "investment" if they were privately held. It could even be argued that durable goods and structures used in defending our country are productive in that they enable us to maintain our institutions in a hostile world.

### No Panacea

More significantly, it is far from clear whether *any* of the popular measures of capital formation, for individuals or for the economy as a whole, imply much about future economic well-being. As we have demonstrated, estimates of personal or individuals' savings mainly reflect the allocations among sectors, and the totals reflect arbitrary judgments concerning what is useful for the future and how rapidly the stock of such items is being consumed.

Even if an indisputably exact measure of what is set aside for the future could be devised, the amount would be only part of the story. Economic growth requires not only capital formation but also the allocation of that capital to useful purposes. Some of the highest rates of capital formation in the world have been achieved by centrally planned economies (such as China during the "Great Leap Forward"), but their "investments" did not increase the output of anything that the people needed or wanted.

An increased savings rate and more capital formation in the United States, or anywhere else, would not automatically lead to more economic growth or a higher standard of living. The assets constituting savings must be valued by the people. There is no foolproof way to ensure this. Economic arrangements that rely on the incentives and penalties of the marketplace tend to do a better job than those based on the choices of regulators and central planners. Thus, a genuine "supply-side" policy needs to address the mechanism by which capital is invested as well as the rate of capital formation.

## INFLATING AND GOLD PRICES, SHORT-TERM AND LONG

*The current moderation of general price rises and the current slide in the dollar price of gold seem to reflect cyclical conditions, not an end to the inflationary era.*

The recent downward slide in the price of gold to below \$390 per ounce, after it held in the \$400 to \$440 range from March through September, has again raised questions about the near-term and long-term future price of gold. Implicit in the latter is the question of expected future inflationary (or disinflationary) trends. Because of space limitations, here we provide highly summarized comment on some factors we believe are most pertinent to these questions. Longtime readers probably will appreciate the connections involved more than recent readers. For background, see our December 1982 *Economic Education Bulletin*, "Signs of More Inflating," and our booklets, "Why Gold?," "Understanding the Money Muddle," and "Money, Banking and Inflating."

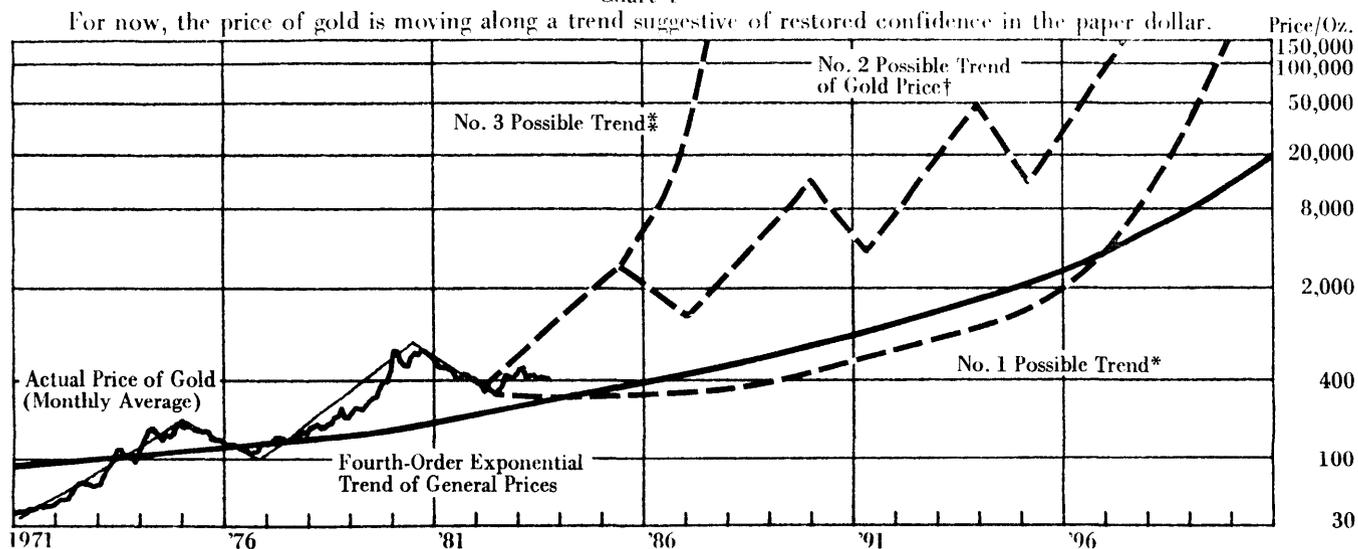
As for the possibility that the long-term trend toward worsening inflating is over, we raise these points:

1. History is replete with episodes of failed experiments with fiat currency. Eventually all fiat currencies sank into extinction or were rescued as part of a major monetary reform. We have not yet had such a reform in this episode. Those who assert that this episode is different have the burden of convincingly supporting their view.

2. Fiat currencies fail because, among other reasons, short-run incentives to inflate — for both central bankers and private bankers — far outweigh the immediate risks of doing so. The long-run costs of inflating are much higher. The short-run benefits seem more alluring, except when a flight from currency threatens. At that point the priority is to restore public confidence in the currency so that the inflating game can continue. The sharp rise in the price of gold in 1979-80 (see Chart 1), threatened a flight from the dollar then. A monetary policy of "restraint" was adopted to restore public confidence. Thus far the new "restraint" seems to be working, as it did in the mid-1970's for a time. Insofar as confidence in paper money returns, pressure

Chart 1

For now, the price of gold is moving along a trend suggestive of restored confidence in the paper dollar.

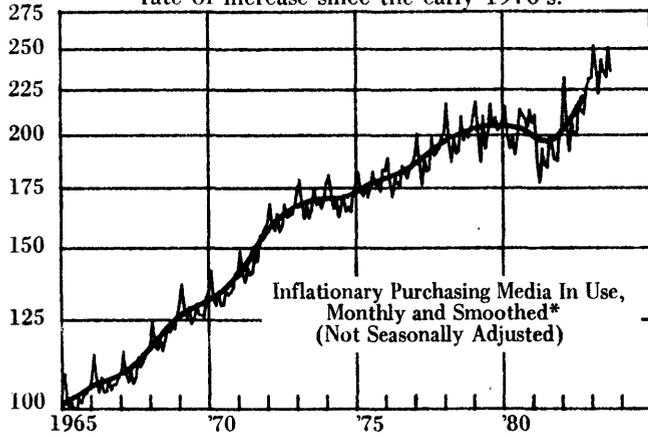


\* Trend if public confidence in paper currencies is maintained in spite of inflating.

† Trend if approximate cycle from 1971 to 1980 is repeated.

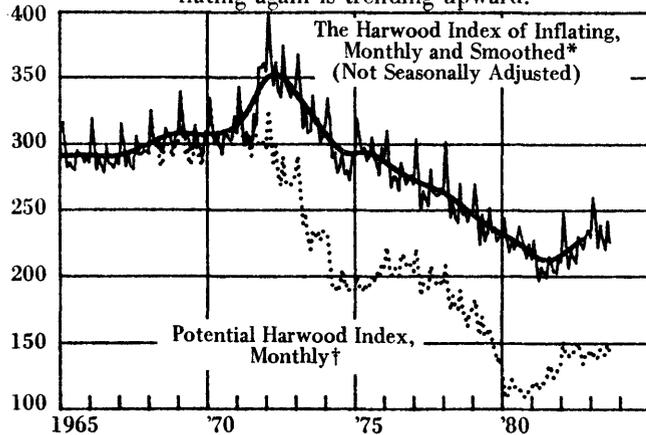
‡ Trend if public awakens early to inflating-embezzling practice and rejects paper currencies.

Chart 2  
Absolute inflating again is occurring, and at the most rapid rate of increase since the early 1970's.



\* Centered, weighted 23-month moving average.

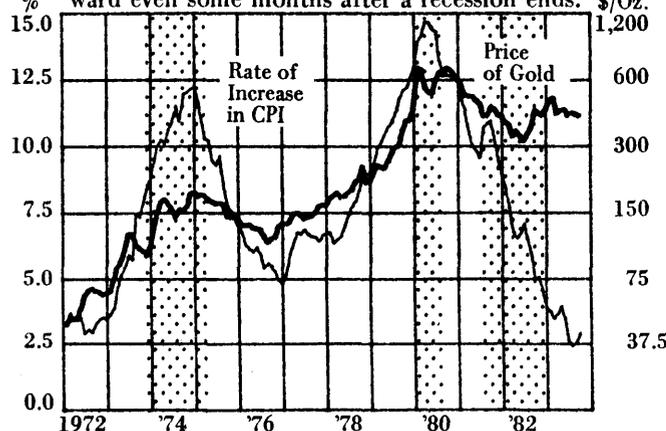
Chart 3  
After trending downward from 1972 to 1981, relative inflating again is trending upward.



\* The smooth curve is a centered, weighted 23-month moving average of the monthly data.

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Chart 4  
It is not unusual for the price of gold to be trending downward even some months after a recession ends. \$/Oz.



Note: The price of gold is the monthly average of the London p.m. fixing, plotted on the right hand (ratio) scale. The rate of change of the Consumer Price Index (CPI) is the increase over a 12-month span, plotted on the left hand (arithmetic) scale. Shaded areas indicate periods of economic recession.

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3. Sharp variations in the rates of growth of key monetary series (M1 and M2) and revisions in announced policy target growth rates (see "The Fed: On Target?," *Research Reports*, September 19, 1983) have obscured the thrust of monetary policy over spans longer than a few months. Furthermore, growth trends in the reported monetary figures do not indicate trends in inflating. Inflating occurs when the amount of purchasing media in use (approximated by the monetary series M1) exceeds the value at the current price level of newly produced goods offered for sale in markets. As Chart 2 reveals, absolute inflating again is increasing, after decreasing somewhat during 1980 and the first half of 1981. After trending downward from 1972 to mid-1981 (subsequent to a 30-year rise from 100 to 350), relative inflating also is trending upward. This is revealed by the Harwood Index of Inflating, plotted in Chart 3, which is a ratio of the amount of inflationary purchasing media in use to the noninflationary amount. These upward trends of both absolute and relative inflating imply that unrecognized inflationary distortions again are building in the economy.

How the inflationary distortions will be manifest in the immediate future is anybody's guess. Presently, the unrecognized inflating seems to be having the stimulative effect on real output that inflating did before the public became widely sensitive to "inflation" in the 1970's. This is indicated by the 11-month-long cyclical economic recovery during which broad price indexes (for example, the Consumer Price Index in Chart 4) have moderated in spite of rapid, if variable, increases in money stock measures (referred to earlier) and continuing high levels of Federal Budget deficits and spending. Moreover, the foreign-exchange value of the paper dollar has been rising during this time. This indicates that the foreign demand for dollar-denominated assets has been greater than the demand for foreign currencies or other foreign assets.

That cyclical conditions at this point continue to be favorable for the paper dollar (and unfavorable for the price of gold) is not surprising. Not until 17 months after the trough of the 1973-75 recession did the dollar price of gold bottom out; consumer price increases continued to moderate a few months longer than that (see Chart 4). Other measures of prices also did not spiral upward until 12 to 24 months after the March 1975 recessionary trough. Of course, the timing of the appearance of inflationary symptoms could be much different this cycle from those of the prior cycle. The longer duration of little or no economic growth from the beginning of 1980 to the end of 1982 may tend to delay the reappearance of sharp price rises and a weakening dollar. On the other hand, unless Americans have no memory of the 1970's, once they recognize that inflating again is accelerating, as suggested by Charts 2 and 3, the upward spiral of general prices and the price of gold could well break out with a shorter lag.

#### PRICE OF GOLD

	1982	1983	
	Nov. 4	Oct. 27	Nov. 3
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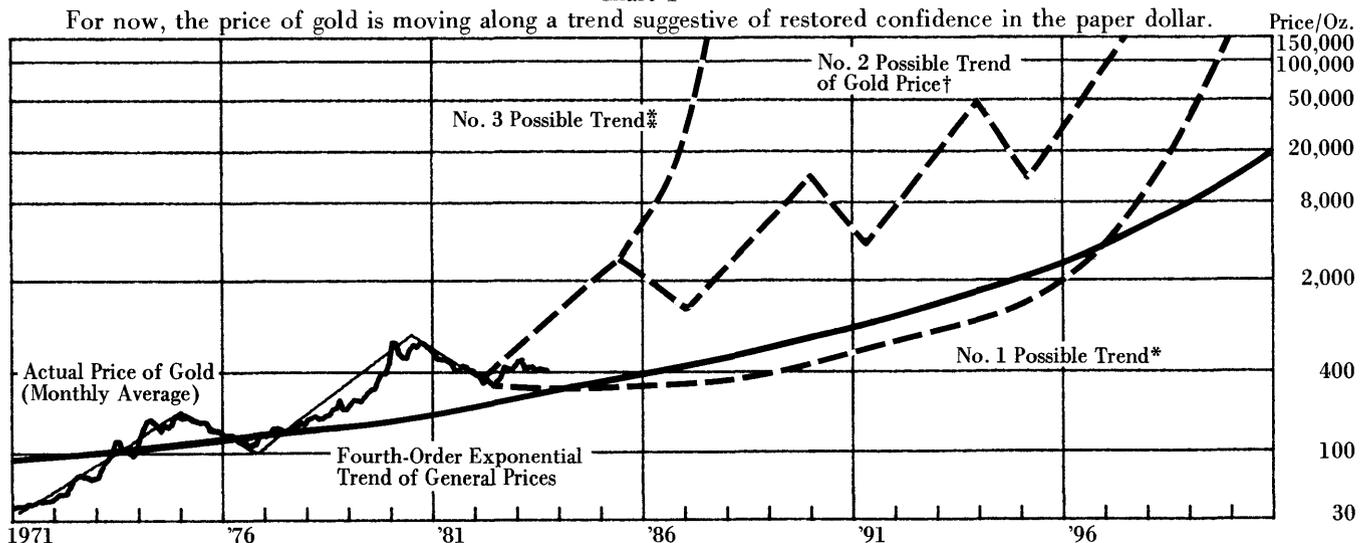
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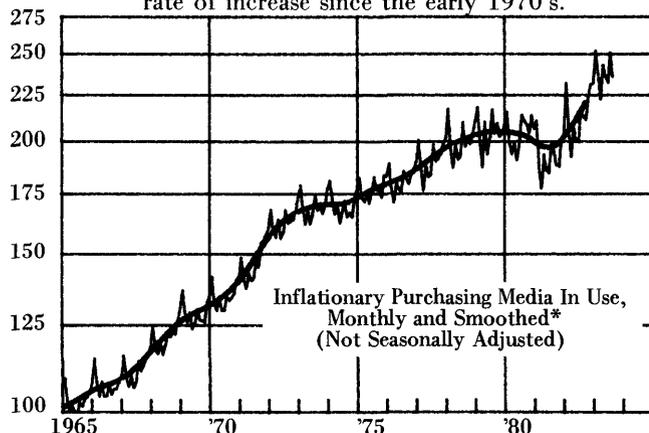
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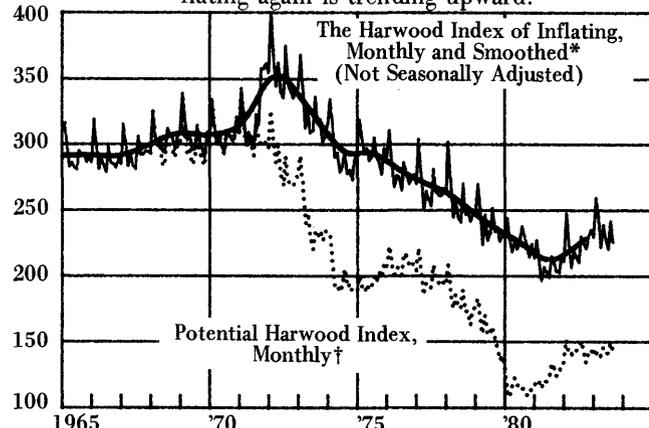
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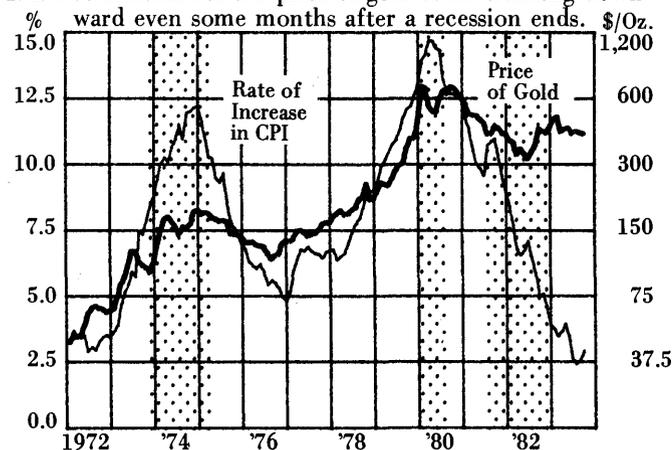


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