Taylor & Francis
Taylor & Francis Group

Bad Data Drive out Good: The Decline of Personal Savings Reexamined
Author(s): Fred Block
Source: *Journal of Post Keynesian Economics*, Vol. 13, No. 1 (Autumn, 1990), pp. 3-19
Published by: Taylor & Francis, Ltd.
Stable URL: http://www.jstor.org/stable/4538220
Accessed: 13-09-2016 03:14 UTC

JSTOR is a not-for-profit service that helps scholars, researchers, and students discover, use, and build upon a wide range of content in a trusted digital archive. We use information technology and tools to increase productivity and facilitate new forms of scholarship. For more information about JSTOR, please contact support@jstor.org.

Your use of the JSTOR archive indicates your acceptance of the Terms & Conditions of Use, available at http://about.jstor.org/terms

Taylor & Francis, Ltd. is collaborating with JSTOR to digitize, preserve and extend access to *Journal of Post Keynesian Economics*

www.manaraa.com

This content downloaded from 137.122.8.73 on Tue, 13 Sep 2016 03:14:11 UTC
All use subject to http://about.jstor.org/terms

FRED BLOCK

Bad data drive out good: the decline of personal savings reexamined

The adequacy of private savings in the United States has become a major topic of debate among economists. The consensus view is that private savings—and especially household savings—declined sharply during the 1980s. This view is given strong support by data in the National Income and Product Accounts (NIPA), which show that personal savings as a percentage of disposable personal income dropped from 7.5 percent in 1981 to a low of 3.2 percent in 1987. However, the consensus view has been challenged by a number of economists who have raised questions about the appropriate way to measure private savings (Eisner, 1989; Lipsey and Kravis, 1987; Blecker, 1990).

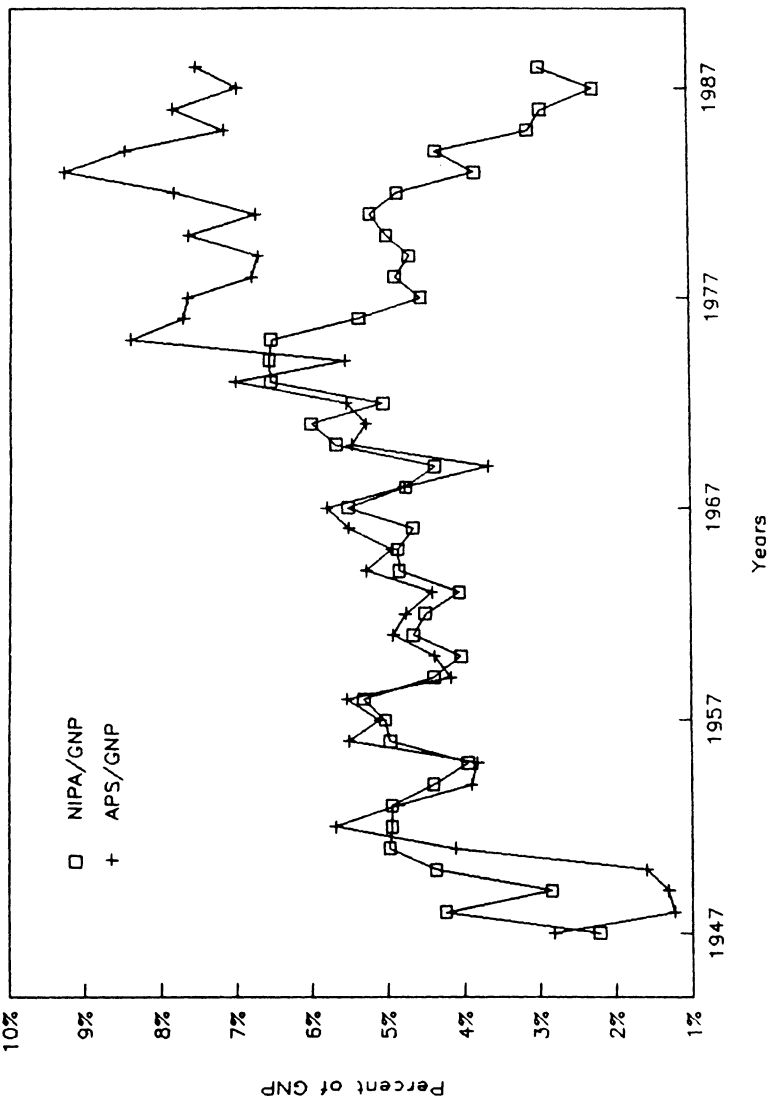
This paper also challenges the conventional view by examining several problems with the NIPA and by turning to an alternative data source—the Federal Reserve Board's Flow of Fund data. With some modifications, the Federal Reserve data can be used to generate an Alternative Personal Savings (APS) measure that is conceptually similar to the NIPA measure. Significantly, these two measures are very similar for the period from 1953 to 1974, and then they diverge sharply (see Figure 1). By 1987—the low point for the NIPA figure—the alternative measure is three times as great as the NIPA measure.

Since personal savings represent a large share of total private savings,

The author is at the Department of Sociology, University of Pennsylvania, Philadelphia, and the University of California, Davis. He is grateful to F. Gerard Adams, Eileen Applebaum, Alan Auerbach, Harold Benenson, Robert Blecker, Fumio Hayashi, Robert Heilbroner, Robert Inman, Jerry Jacobs, John Judis, Karl Klare, Robert McIntyre, Samuel Preston, Bill Tabb, Michael Weinstein, and an anonymous referee for comments on an earlier version, but since he has been selective in following their advice, they are absolved from all responsibility for errors or weaknesses in the argument.

This content downloaded from 137.122.8.73 on Tue, 13 Sep 2016 03:14:11 UTC
All use subject to http://about.jstor.org/terms

Figure 1 Measures of personal savings



This content downloaded from 137.122.8.73 on Tue, 13 Sep 2016 03:14:11 UTC
All use subject to http://about.jstor.org/terms

whether personal savings in 1988 were $144.7 billion or $367.3 billion has extremely serious implications for economic analysis and economic policy. The former figure supports a view of money capital in the United States as an extremely scarce resource. The latter figure suggests that money capital in the United States is abundant relative to the opportunities for productive investment. These different interpretations will be addressed in the paper's conclusion.

Personal savings in the NIPA

Personal savings are calculated by subtracting the total of personal consumption expenditures from disposable personal income. It is well known that such a residual calculated by subtracting one large figure from another large figure is extremely sensitive to small changes in either of the large numbers. For example, if the disposable personal income figure for 1983 were 10 percent higher, the personal savings figure would increase by more than 217 percent. Both disposable personal income and personal consumption expenditures are estimated on the basis of a great deal of direct data, but the government economists make the best approximations they can for a variety of components where direct data are insufficient or inaccurate.

There would be no problem with this procedure if the government economists had a means to cross-check their data against other data sources. As we shall see, when such a comparison is carried out with Federal Reserve Board Flow of Funds' data on financial savings by households, it becomes clear that there is something seriously wrong with the NIPA data.

One problem with the NIPA data centers on the treatment of pension and welfare funds. The architects of the National Income accounts decided to include private employer contributions to pension and social insurance funds, categorized as "other labor income," as a component of personal income, despite the fact that these funds do not go directly into employees' paychecks. At the time that the accounts were constructed, all of these flows were tiny, but with the expansion of pension and health insurance, these items are now enormous. While the initial decision was logical in terms of the overall system of accounts, it creates a problem for accurately measuring personal savings.

The problem is that the income individuals actually receive—and that can be used for savings—in any given year are the benefits that employ-

This content downloaded from 137.122.8.73 on Tue, 13 Sep 2016 03:14:11 UTC
All use subject to http://about.jstor.org/terms

ees or retirees receive from these funds. These benefit flows are not included in personal income in order to avoid double counting. However, it turns out that employer contributions exceeded benefits for every year until 1984, and since then benefits have risen more rapidly than contributions. By 1988, benefits exceeded contributions by $93.8 billion (*Survey of Current Business*, July 1989). Since the annual growth of private pension fund assets, exclusive of capital gains, has been healthy in this period, it would seem that NIPA procedures understate the total contribution of private pensions to personal savings.[1]

At the same time, the NIPA data neglect employer contributions to those public sector pension funds at the state or local levels that are organized in the same way as private pension funds. In 1985, according to one recent study, including public sector pension funds in the accounts would raise NIPA savings as a percentage of disposable income by almost two full percentage points (Holloway, 1989, p. 60). In 1988, this adjustment would increase NIPA savings rate as a percentage of GNP to 4.4 percent.[2]

Another serious problem with the NIPA data is the classic problem of underreporting of legally earned income. During the Reagan years, IRS funding was cut back severely and the probability of being audited diminished substantially.[3] At the same time, personal enrichment was glorified as the ultimate value. In such a context, it seems likely that tax cheating increased, despite the reduction in marginal rates in 1981. If the chances of being caught diminish substantially, a 0 percent marginal rate will be preferred to a 25 percent marginal rate. However, an increase in the rate of noncompliance with the tax code will mean that NIPA figures understate personal income and personal savings.

The problem of underreporting income is largely concentrated in nonfarm proprietorships, since most wage and salary income is reported directly to the IRS by employers. In its 1985 comprehensive revision of

[1] NIPA does include interest and dividends earned by private pensions as part of personal income. However, an ideal accounting of pension funds would capture both the annual net increase in pension funds assets and the flow of services received as benefits. Data on annual increases in pension fund assets are provided in the Federal Reserve Board, Flow of Funds Section, *Flow of Funds Accounts*.

[2] To be sure, changing the accounting of public sector pension funds has the effect of increasing the public sector deficit. The 1988 calculation is based on unpublished data provided by the Bureau of Economic Analysis, U.S. Department of Commerce.

[3] The audit rate dropped from 2.12 percent in 1980 to 1.03 percent in 1988 (Kagan, 1989, p. 116; Lasser, 1989, p. 384).

This content downloaded from 137.122.8.73 on Tue, 13 Sep 2016 03:14:11 UTC
All use subject to http://about.jstor.org/terms

the national accounts, Bureau of Economic Analysis economists made substantial upward revisions of nonfarm proprietor income, which had the effect of increasing the personal savings rate above the previously published level by 1 percentage point per year for 1978–80.[4] This revision was based on IRS studies from 1976. The first data came from the IRS' Taxpayer Compliance Measurement Project (TCMP)—studies completed every three years that involve a detailed audit of a random sample of tax returns. These studies establish the Voluntary Reporting Percentage (VRP) for different categories of income for the study year. A second IRS study based on computer matching of data attempted to estimate how much unreported income was successfully uncovered by the TCMP audits. The latter study found that for every $1.00 of unreported income for nonfarm proprietors detected by the TCMP audit, there was another $3.50 of unreported income that was not detected. In other words, a Voluntary Reporting Percentage of 80 percent in the TCMP actually meant that only 47 percent of taxable income was being reported.

The problem is that the current NIPA figures continue to be based on the 1976 VRPs, despite the fact that the IRS has reported that the VRP for nonfarm proprietors dropped from 81 percent in 1976 to 76 percent in 1979, and to 68 percent in 1982. (The 1985 figures have not yet been released.) If the TCMP audits continue to find only $1.00 for every $3.50 of unreported income, then it is possible to make some rough calculations to show the impact of different VRPs on personal income. If one begins with the nonfarm proprietor income reported to the IRS for 1987 and assumes that the VRP fell to 70 percent, it would add about $85 billion to personal income. A decline of the VRP to 60 percent would add about $195 billion to personal income.[5] Moreover, given the year-to-year decline of the VRP, it is entirely possible that by the 1988 TCMP, the VRP had actually declined to 50 percent.

A final problem with the NIPA data is its treatment of spending by households on real estate, including the purchase of owner-occupied housing. In theory, the personal savings figure should include both the

[4] The methodology of the revisions is described in Parker (1984). See Holloway (1989, p. 51) for the revision to the savings figures.

[5] These calculations draw on the reconciliation data in Park (1989). That source also shows that the gap between IRS adjusted gross income for nonfarm proprietors and BEA adjusted gross income was much smaller for 1987 than for previous years. The gap declined as a percentage of BEA income, from 60.5 percent in 1986 to 48.6 percent in 1987. This very large drop-off is another source of the very low personal savings figure for 1987. Park suggests that the 1987 data might reflect changes in the tax law in 1986 with regard to the deductibility of passive activity losses.

This content downloaded from 137.122.8.73 on Tue, 13 Sep 2016 03:14:11 UTC
All use subject to http://about.jstor.org/terms

acquisition of financial and real assets by households, since only consumption expenditures are being subtracted from disposable income. However, the national income accountants treat owner-occupiers as though they rented their homes and an imputed rent figure for owner-occupiers ($339.3 billion in 1988) is added to actual rents of tenants as an important component of personal consumption expenditures. Some fraction of this imputed rent is also credited to owner-occupiers as a component of personal income, but with the inclusion of depreciation, this figure has actually been negative in recent years.[6] It is difficult to sort out how these figures relate to the actual housing expenditures of owner-occupiers, but the BEA figure seems too high. Moreover, the final cost of owner-occupied housing as a percentage of disposable personal income rose from 4.4 percent in 1960 to 5.2 percent in 1988. While the issue of housing does not play a central role in the rest of this paper, it is of critical importance for comparisons of savings rates across countries. Procedures for handling owner-occupied housing and imputing rents vary across countries, and it is entirely possible that these differences in methodology explain a portion of the substantial differences in savings rates across countries.[7]

Alternative data

There is an alternative data source that can be used to assess these problems with the NIPA data on personal savings. The Federal Reserve Board compiles data on the amount of money flowing from households into a variety of financial instruments. These data are also largely indirect; in analyzing data from banks, insurance companies, pension funds, and so forth, the board's economists attribute to households those flows that are not otherwise accounted for.[8] These data are readily

[6] It seems likely that the BEA's replacement cost adjustment for calculating depreciation exaggerates the growth of depreciation in the entire economy since 1974. This would also contribute to the understating of personal savings in the National Income and Product Accounts.

It should also be noted that another fraction of the imputed rent on owner-occupied husing is attributed to individuals as interest income.

[7] There are also significant differences across countries in the relative cost of land. It seems quite likely that a significant portion of the United States–Japan difference in personal savings rates can be traced to the higher price of land in Japan. Goldsmith (1985, p. 122) reports that in 1978 land represented twice as large a percentage of all tangible assets in Japan as in the United States.

[8] However, the board also carries out a periodic survey of consumer finance that

This content downloaded from 137.122.8.73 on Tue, 13 Sep 2016 03:14:11 UTC
All use subject to http://about.jstor.org/terms

available; they are published annually in the *Economic Report to the President* in a table entitled "Savings by Individuals."[9]

In this series, the Federal Reserve economists add the increase in financial assets by households to net investments in housing and consumer durables, and then subtract increases in personal debt, such as home mortgages and consumer credit. Conceptually, this series is comparable to the NIPA series in that both are measures of net savings; an allowance for the depreciation of physical assets is not included.[10] However, the FRB economists differ from the NIPA economists in treating purchases of consumer durables as a form of savings.

However, since the underlying issue in the debate about savings is the ability of households to provide a financial surplus that is available for investment by the business sector, it makes sense to focus only on the net acquisition of financial assets by households. The alternative personal savings figure presented in Table 1 modifies the FRB data by dropping out purchases of consumer durables, spending on owner-occupied housing, and the net increases in mortgage debt.

Mortgage debt is subtracted out for reasons of symmetry. It would be illogical to exclude the accumulation by households of tangible assets—housing—while including the liabilities (the mortgages) incurred in purchasing those assets. In fact, the quantity of the mortgage debt directly reflects not just flows of savings into real estate, but the annual appreciation of real estate values. In order to balance the annual increase in mortgage debt appropriately, one would have to compare it to the annual change in the total value of owner-occupied housing—a figure that rose rapidly in the 1981–88 period (see Table 2).

One can also gain some leverage on this issue by thinking about the comparison between the United States and a country such as Japan, where mortgage financing is scarce. In the absence of readily available

---

generates a large amount of data on the actual financial behavior of a sample of households.

[9] This series combines savings by households, personal trust funds, nonprofit institutions, farms, and other noncorporate businesses. This makes the series broader than the BEA measure of personal savings, although household savings is by far the dominant component of the FRB series. Nevertheless, this broader coverage seems appropriate in relation to the underlying question of the capacity of the noncorporate part of the economy to contribute resources to finance corporate investment.

[10] Both of these series also omit capital gains, although the FRB does provide another series that estimates annual appreciations of asset values. (See Federal Reserve Board, Flow of Funds Section, *Balance Sheets for the U.S. Economy*. This relation

This content downloaded from 137.122.8.73 on Tue, 13 Sep 2016 03:14:11 UTC
All use subject to http://about.jstor.org/terms

Table 1

NIPA Savings versus APS

year	*APS (billions of $)*	*NIPA/GNP*	*APS/GNP*	*difference as % of NIPA*
1947	6.6	2.2 %	2.8 %	–26.9 %
1948	3.2	4.2 %	1.2 %	71.2 %
1949	3.4	2.8 %	1.3 %	54.1 %
1950	4.6	4.4 %	1.6 %	63.5 %
1951	13.7	5.0 %	4.1 %	17.5 %
1952	20.0	4.9 %	5.7 %	–14.9 %
1953	18.1	5.0 %	4.9 %	1.6 %
1954	14.5	4.4 %	3.9 %	11.6 %
1955	15.5	3.9 %	3.8 %	3.1 %
1956	23.6	5.0 %	5.5 %	–10.8 %
1957	23.0	5.0 %	5.1 %	–1.3 %
1958	25.3	5.3 %	5.5 %	–4.1 %
1959	20.7	4.4 %	4.2 %	5.0 %
average 1947–59		4.4 %	3.8 %	13.0 %
1960	22.6	4.0 %	4.4 %	–8.7 %
1961	26.3	4.7 %	4.9 %	–5.6 %
1962	27.4	4.5 %	4.8 %	–5.8 %
1963	26.8	4.1 %	4.4 %	–8.9 %
1964	34.3	4.8 %	5.3 %	–8.9 %
1965	34.9	4.9 %	4.9 %	–1.7 %
1966	42.5	4.7 %	5.5 %	–18.1 %
1967	47.4	5.5 %	5.8 %	–5.1 %
1968	42.7	4.8 %	4.8 %	–0.5 %
1969	35.4	4.4 %	3.7 %	16.1 %
average 1960–69		4.6 %	4.8 %	–4.7 %

mortgages, many housing transactions are financed through loans from other family members (Makin, 1986, p. 103). A buyer might provide 40 percent of the purchase price at the time of sale, and then promise to pay off the other 60 percent over the next twenty years at a particular interest rate. Such private transactions, however, would have no impact at all on the household savings rate, since one household's assets are directly offset by the other's liabilities. In other words, the transfer of existing housing between individuals does not influence the total supply of household savings available for other purposes. The same would appear

This content downloaded from 137.122.8.73 on Tue, 13 Sep 2016 03:14:11 UTC
All use subject to http://about.jstor.org/terms

Table 1 (continued)

year	APS (billions of $)	NIPA/GNP	APS/GNP	difference as % of NIPA
1970	55.5	5.7 %	5.5 %	3.8 %
1971	58.2	6.0 %	5.3 %	12.2 %
1972	67.2	5.1 %	5.5 %	–9.4 %
1973	95.4	6.5 %	7.0 %	–7.2 %
1974	81.9	6.6 %	5.6 %	15.3 %
1975	134.5	6.5 %	8.4 %	–28.6 %
1976	137.3	5.4 %	7.7 %	–43.4 %
1977	152.3	4.6 %	7.7 %	–67.9 %
1978	152.8	4.9 %	6.8 %	–38.7 %
1979	168.3	4.7 %	6.7 %	–42.5 %
average 1970–79		5.6 %	6.6 %	–20.6 %
1980	208.5	5.0 %	7.6 %	–52.3 %
1981	206.0	5.2 %	6.7 %	–29.2 %
1982	247.8	4.9 %	7.8 %	–61.0 %
1983	316.2	3.8 %	9.3 %	–142.1 %
1984	319.4	4.4 %	8.5 %	–94.6 %
1985	287.5	3.1 %	7.2 %	–129.3 %
1986	331.6	3.0 %	7.8 %	–165.5 %
1987	316.3	2.3 %	7.0 %	–210.7 %
1988	367.3	3.0 %	7.5 %	–153.8 %
average 1980–88		3.8 %	7.7 %	–110.6 %

Source: All data are from the *Economic Report to the President, 1990.*

to be true even when the transactions are mediated through banking institutions.

It is true, however, that tax law changes that reduced the deductibility of consumer debt have led to some substitution of mortgage debt—in the form of second mortgages and home equity loans—for consumer credit. Between 1985 and 1988, annual increases in consumer credit dropped from $82.5 billion to $51.1 billion, while mortgage indebtedness rose relative to personal income. In calculating alternative personal savings, an adjustment for this substitution has been made by assuming

This content downloaded from 137.122.8.73 on Tue, 13 Sep 2016 03:14:11 UTC
All use subject to http://about.jstor.org/terms

Table 2

Components of savings

	1 *financial assets*	2 *consumer debt*	3 *mortgage debt*	4 *housing investment*	5 *value of housing*
1975	176.4	41.9	38.8	27.5	95.3
1976	206.1	68.8	60.8	41.9	182.9
1977	253.4	101.1	91.5	61.0	269.1
1978	285.8	133.0	109.4	77.8	330.8
1979	327.0	158.7	117.1	86.7	308.2
1980	321.3	112.8	96.4	66.6	244.9
1981	323.3	117.3	73.8	59.7	377.7
1982	379.3	131.5	52.9	35.6	–42.3
1983	495.4	179.2	120.4	76.2	158.3
1984	563.7	244.3	136.7	95.4	180.2
1985	568.0	280.5	157.0	97.1	168.2
1986	561.2	229.6	165.7	114.6	285.4
1987	512.1	195.8	176.3	134.0	310.2
1988	569.2	201.9	191.3	151.3	313.1

Source: Column 1 is the increase in financial assets held by households from the Federal Reserve Board Flow of Funds. *Column 2* is the increase in household debt, exclusive of mortgage debt reported in the same series. APS equals column 1 minus column 2. *Column 3* is the annual increase in mortgage debt in the FRB series. Both columns 2 and 3 differ from the published data for 1986–88 because some of the increased mortgage debt was attributed to household debt in light of the increased use of second mortgages and home equity loans for non-housing purchases. *Column 4* is net expenditures on owner-occupied housing reported in the same series. *Column 5* is the annual increase in the value of owner-occupied land and housing as reported in Federal Reserve Board, *Balance Sheets for the U.S. Economy 1949–1988*. Note that this last column is the only one that incorporates capital gains.

that new mortgage debt for 1986 through 1988 was in the same ratio to disposable personal income as in 1985, and increases over that amount were attributed to increases in consumer debt. This adjustment has the effect of lowering alternative personal savings for 1986 through 1988.

In comparing the alternative personal savings figure to the NIPA figure, it is clear that the two series are quite similar in magnitude and

This content downloaded from 137.122.8.73 on Tue, 13 Sep 2016 03:14:11 UTC
All use subject to http://about.jstor.org/terms

direction of change in the period from 1953 until 1974. In the 1960s, for example, the discrepancy between the two series averaged only 4.7 percent of NIPA savings. This similarity provides substantial support for the claim that these two very different series are measuring the same thing. However, starting in the mid 1970s and accelerating in the 1980s, the two series diverge rapidly. Moreover, the alternative figure has clearly risen as a percentage of GNP, with the levels of the 1980s representing historic highs.

It seems probable that the treatment of pensions, the treatment of owner-occupied housing in the NIPA system, and the underreporting of legally earned income explain much of this discrepancy.[11] It has been argued, however, that the NIPA data are superior to the FRB data, because the latter source has been contaminated by unrecorded inflows of foreign capital (de Leeuw, 1984). The idea is that foreign acquisitions of financial assets in the United States that are not properly reported end up being attributed to U.S. households, thus improperly inflating the estimate of U.S. household savings. While this argument seems plausible, there is one serious problem. The assets accumulated by pension funds and insurance reserves represent a rising share of all of the financial asset acquisitions reported in the Federal Reserve data; they rose from 57 percent of alternative personal savings in 1981 to 61.1 percent in 1988. In short, the component of alternative personal savings that is measured most directly and is most likely to represent holdings of U.S. households has been rising. This makes it implausible that the Federal Reserve figure has been significantly inflated by unrecorded capital inflows.

One final point deserves mention here. The alternative savings series focuses only on financial savings, while the NIPA figure probably does the same by virtue of its treatment of owner-occupied housing. However, one of the most important ways in which individuals save is by raising the quality of their "human capital." A substantial component of what individuals spend for education and for health care can reasonably be seen as this kind of "intangible" savings. One recent study calculated these types of savings to be $348.6 billion in 1981 and found that intangible savings by households have been rising as a percentage of

[11] One other possibility is that the divergence has to do with the expansion of the illegal drug trade. NIPA data deliberately exclude income produced in such illegal activities as drug trafficking. However, the FRB data include flows of funds into financial instruments regardless of their legality. Yet this seems unlikely to explain much of the discrepancy, since drug profits that remain in the country enter the legitimate economy and are eventually reflected in the NIPA figures.

This content downloaded from 137.122.8.73 on Tue, 13 Sep 2016 03:14:11 UTC
All use subject to http://about.jstor.org/terms

GNP (Eisner, 1985). Other studies that have sought to measure the value of these forms of intangible household savings through calculations of the returns to education over the lifecourse have generated much higher annual estimates that overwhelm the other components of personal savings (Kroch and Sjoblom, 1986; Jorgenson and Pachon, 1983). The neglect of these other forms of household savings in the official data is another reason for extreme caution in drawing policy conclusions from the movements of these series.

Significance of the data

In the current debate about the decline of personal savings, the key argument is that the low rate of personal savings in the United States creates difficulties for the financing of productive investment. There are several versions of the argument. In one, the point is that the scarcity of personal savings in the United States makes capital more expensive in the United States relative to countries such as Japan, where the personal savings rate is higher. The higher interest rates discourage certain types of productive investment that would occur at lower interest rates (Hatsopoulos, Krugman, and Summers, 1988). In another, the low savings rate in the United States has forced the United States to borrow capital from abroad to finance new investment—a move that cannot be continued indefinitely (*Economic Report to the President, 1990*, pp. 123–129).

All of these arguments rest on a comparison between trends in personal and private savings and trends in domestic private investment. Such comparisons rarely involve a developed theory about how different kinds of savings flows are used to finance different types of investment. However, when the NIPA data on personal savings are used, the impact of these impressionistic comparisons is powerful; they suggest a significant shortfall of personal savings. Hence, it seems useful to make the same kind of impressionistic comparison of the alternative personal savings figures with private investment trends in the economy. To be sure, domestic investments can be financed by international capital flows, but the international capital markets do not work perfectly. In fact, some of the leading theorists of the savings shortfall in the United States have noted that there remains a strong relationship between domestic savings rates and domestic investment rates, indicating that

This content downloaded from 137.122.8.73 on Tue, 13 Sep 2016 03:14:11 UTC
All use subject to http://about.jstor.org/terms

we are still far from a world of perfect mobility of money capital across international lines (Hatsopoulos, Krugman, and Summers, 1988).

Figure 2 provides some surprising results. For the years from 1975 to 1988, when APS diverges from NIPA savings, APS grows as a percentage of gross private investment and it rises significantly in relation to net private investment.[12] A number of analysts have recently noted the sharp decline in net investment relative to gross investment in the U.S. economy. This increase in the percentage of investment attributed to depreciation has been explained in terms of the shortening of the service lives of capital goods (Blecker, 1990; Summers, 1983).[13] But whatever the cause, the result is that the use of new investment funds has diminished relatively, so that by the 1980s APS exceeded net private investment in every year. The data suggest an increasing supply of personal savings relative to the amount of net private investment actually taking place. This is a picture that runs directly against the conventional wisdom that household savings are increasingly in short supply. Moreover, when undistributed corporate profits (with inventory valuation adjustment and capital consumption adjustment) are added to APS to create a private savings series, the results are even more dramatic.

To be sure, a complete account of national savings requires including the role of the public sector. However, the proper way to measure public sector savings or dissavings is a controversial issue that is well beyond the scope of this paper (see Eisner, 1986; Heilbroner and Bernstein, 1989). At the very least, available data would have to be adjusted to include government civilian investment as a contribution to national savings.[14] It is relevant, however, to note that for every year of the 1980s, private savings exceeded net private domestic investment by an amount larger than the total government deficit—including off-budget items—reported in the NIPA, and in some years, the surplus exceeded $100 billion.

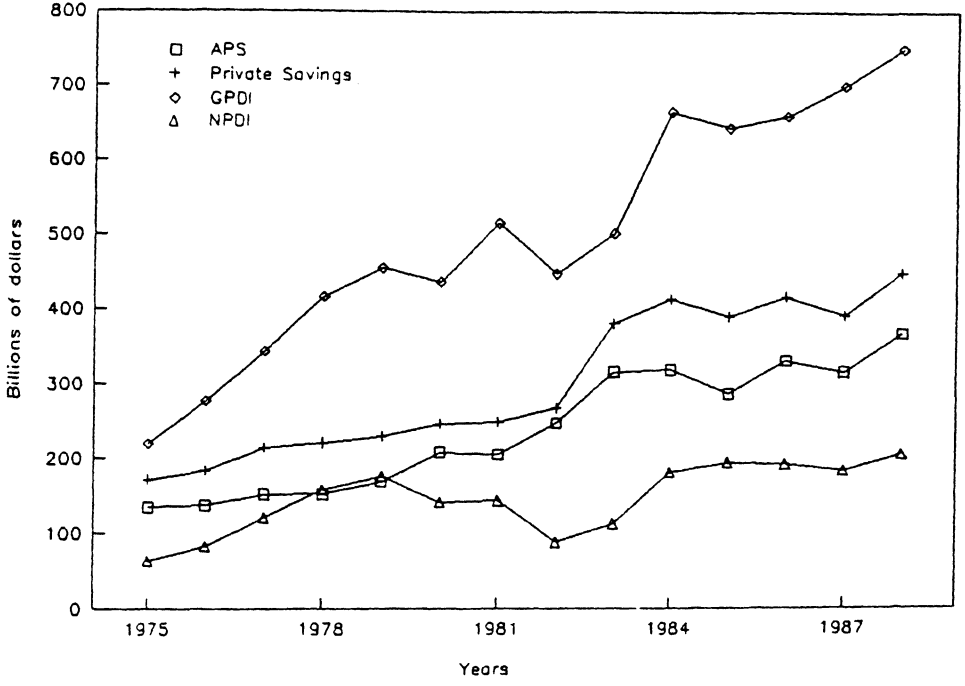
[12] The strength of APS relative to gross private domestic investment is significant in light of the Council of Economic Advisors' conclusion that: "During the long expansion since 1982, however, U.S. real gross investment performance has been quite strong" (*Economic Report to the President, 1990*, p. 119).

[13] Another possibility is that the decline of net investment can be traced to some combination of changes in the tax laws and weaknesses in the NIPA adjustments for the replacement costs of capital goods. On the latter point, see Eisner (1983).

[14] Published data would also have to be adjusted to compensate for the fact that the FRB series does include public employer contributions to pension fund reserves. This requires a compensating adjustment to governmental budget figures.

This content downloaded from 137.122.8.73 on Tue, 13 Sep 2016 03:14:11 UTC
All use subject to http://about.jstor.org/terms

Figure 2 Savings vs. investment



Sources:

1. Alternative Personal Savings is drawn from Table 1.
2. Private Savings equals APS plus Undistributed Corporate Profits with inventory valuation and capital consumption adjustments.
3. GPDI equals gross private domestic investment.
4. NPDI equals net private fixed investment.

All data are from *The Economic Report to the President, 1990.*

This content downloaded from 137.122.8.73 on Tue, 13 Sep 2016 03:14:11 UTC
All use subject to http://about.jstor.org/terms

Interpretation and conclusion

The obvious objection that will occur to most readers is that, since real interest rates have remained at relatively high levels in the 1980s, it follows that the kind of abundance of savings the data describe could not exist. Yet such an argument represents a partial and misleading application of the law of supply and demand. If private savings are large and expanding relative to real investment, the likely consequence is a rapid bidding up of the prices of assets such as real estate and corporate stocks. As long as the flows of new savings are continuous, this appreciation of asset values will be continuous and highly profitable for investors. The result is a virtually inelastic supply of speculative investment opportunities with a high rate of return. For example, in 1988, the stock market provided a total return (price increases plus reinvested dividends) of 16.5 percent.

Moreover, as long as investors can make 16.5 percent on their capital in the market in a given year, demand for credit will remain strong. People and institutions will cheerfully borrow billions at 10 or 12 percent in order to gain returns of 16.5 percent. This demand for credit will, in turn, slow any significant decline in interest rates. Those selling fixed income securities such as bonds will be forced to pay a higher interest rate to prevent investors from shifting into those speculative assets that offer significantly higher rates of return. To be sure, markets based on this kind of dynamic are likely to be extremely volatile, since prices are based not on expectations about real returns, but on expectations for continuing speculative profits. Yet as we learned from October 1987, even when such a market crashes, the ample supply of savings reasserts itself and drives prices back up.[15]

While this is not the place to elaborate a theory of how an economy with ample supplies of private savings operates, a few final comments are in order. First, the argument being advanced here draws support from an unlikely source—Michael Milken, the now convicted junk bond king. In her book, *The Predators' Ball*, Connie Bruck writes, "The common perception is that capital is scarce, Milken declared in his timeworn message, but in fact capital is abundant; it is vision that is scarce" (p. 272). Milken's genius was to understand the reality of a capital-abundant economy and to devise new financial instruments that took advan-

[15] These speculative markets have also attracted inflows of savings from abroad. This helps explain how the United States can be a net importer of capital at the same time that private domestic savings exceed net investment.

This content downloaded from 137.122.8.73 on Tue, 13 Sep 2016 03:14:11 UTC
All use subject to http://about.jstor.org/terms

tage of the abundance of personal savings to create enormous wealth for himself and the corporate takeover artists he financed.

Second, this analysis indicates that the reduction in the capital gains tax being proposed by the Bush administration is doubly wrong. Not only is it unnecessary to create incentives for personal savings that already exist in ample supply, but a cut in the capital gains tax would simply encourage more speculative investments in stocks and real estate that have little to do with the production of real wealth. On the contrary, the fever of speculation and the closely related takeover craze have caused firms to avoid equity financing and shift to debt financing to avoid corporate raiders. Yet whichever way they turn, firms are under mounting pressure to sacrifice long-term considerations for short-term profits (Dertouzos, Lester, and Solow, 1989, chapter 4).

Moreover, the rise of personal savings in the 1980s indicated by the APS data is a direct consequence of the Reagan administration's success in shifting income from the poor to the rich. The share of income earned by the top quintile of families increased from 41.9 percent in 1981 to 43.7 percent in 1986. A reduction in the capital gains tax would further increase this maldistribution of income. The unequal distribution of income makes the economy extremely vulnerable to a shortfall in consumer demand because of the restricted purchasing power of the majority of consumers.

Finally, these findings remind us of Keynes' anticipation of "the euthanasia of the rentier" as capitalist development reduced the scarcity of money capital (Keynes, 1936). The irony is that while the supply of private savings relative to investment has apparently increased, the rentier is more powerful than ever. It would seem that, here again, government action is required to redress the market failures produced by this phase in the development of a market society.[16]

[16] Reorientations of policy in response to changes in the organization of the economy are developed further in Block (1990).

REFERENCES

Blecker, Robert A. *Are Americans on a Consumption Binge? The Evidence Reconsidered.* Washington: Economic Policy Institute, 1990.

Block, Fred. *Postindustrial Possibilities: A Critique of Economic Discourse.* Berkeley: University of California Press, 1990.

Bruck, Connie. *The Predators' Ball: The Junk Bond Raiders and the Man Who Staked Them.* New York: Simon and Schuster, 1988.

This content downloaded from 137.122.8.73 on Tue, 13 Sep 2016 03:14:11 UTC
All use subject to http://about.jstor.org/terms

de Leeuw, Frank. "Conflicting Measures of Private Saving." *Survey of Current Business*, November 1984.

Dertouzos, Michael L.; Lester, Richard K.; and Solow, Robert M. *Made in America: Regaining the Productive Edge*. Cambridge, MA: MIT Press, 1989.

Eisner, Robert. "Discussion." In Federal Reserve Bank of Boston, *Saving and Government Policy*. Boston: Federal Reserve, 1983, 104–109.

_____. "The Total Incomes System of Accounts." *Survey of Current Business*, January 1985, 24–48.

_____. *How Real is the Federal Deficit?* New York: Free Press, 1986.

_____. "The Real Rate of National Saving." Paper presented at the American Economic Association, December 1989.

Goldsmith, Raymond W. *Comparative National Balance Sheets: A Study of Twenty Countries, 1688–1978*. Chicago: University of Chicago Press, 1985.

Hatsopoulos, George N.; Krugman, Paul; and Summers, Lawrence H. "U.S Competitiveness: Beyond the Trade Deficit." *Science*, July 1988, *241*, 299–307.

Heilbroner, Robert, and Bernstein, Peter. *The Debt and the Deficit: False Alarms/Real Possibilities*. New York: W. W. Norton, 1989.

Holloway, Thomas M. "Present NIPA Saving Measures: Their Characteristics and Limitations." In *The Measurement of Saving, Investment, and Wealth*, Robert E. Lipsey and Helen Stone Tice, eds. Chicago: Univ. of Chicago Press, 1989, 21–100.

Jorgenson, D., and Pachon, A. "The Accumulation of Human and Non-Human Capital." In *The Determinants of National Savings and Wealth*, Franco Modigliani and Richard Hemming, eds. New York: St. Martin's Press, 1983, 302–350.

Kagan, Robert A. "On the Visibility of Tax Law Violations." In *Taxpayer Compliance Volume 2: Social Science Perspectives*, Jeffrey A. Roth and John T. Scholz, eds. Philadelphia: University of Pennsylvania Press, 1989, 76–125.

Keynes, John Maynard. *The General Theory of Employment, Interest, and Money*. New York: Harcourt, Brace & World, 1964 [1936].

Kroch, Eugene, and Sjoblom, Kriss. "Education and the National Wealth of the United States." *Review of Income and Wealth*, March 1986, *32* (1), 87–106.

Lasser, J. K. *Your Income Tax*. New York: Simon and Schuster, 1989.

Lipsey, Robert, and Kravis, Irving. *Saving and Economic Growth: Is the United States Really Falling Behind*. American Council of Life Insurance and The Conference Board, 1987.

Makin, John H. "Savings Rates in Japan and the United States: The Role of Tax Policy and Other Factors." In *Savings and Capital Formation: The Policy Options*, F. Gerard Adams and Susan M. Wachter, eds. Lexington, MA: D. C. Heath, 1986, 91–126.

Park, Thae S. "Relationship between Personal Income and Adjusted Gross Income: Revised Estimates, 1985–1987." *Survey of Current Business*, August 1989, 30–32.

Parker, Robert P. "Improved Adjustments for Misreporting of Tax Return Information Used to Estimate the National Income and Product Accounts, 1977." *Survey of Current Business*, June 1984, 17–25.

Roth, Jeffrey A.; Scholz, John T.; and Witte, Ann Dryden, eds. *Taxplayer Compliance Volume 1: An Agenda for Research*. Philadelphia: University of Pennsylvania Press, 1989.

Summers, Lawrence H. "Issues in National Savings Policy." In Federal Reserve Bank of Boston, *Saving and Government Policy*, Boston: Federal Reserve, 1983, 65–88.

This content downloaded from 137.122.8.73 on Tue, 13 Sep 2016 03:14:11 UTC
All use subject to http://about.jstor.org/terms