Despite a Savings Rate of Just 0.2%, Americans Are as Thrifty as They've Ever Been
BY By Gene Epstein 08/10/98
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Charles Dickens' Mr. Macawber said it best: "Annual income twenty pounds, annual expenditure nineteen nineteen six, result happiness. Annual income twenty pounds, annual expenditure twenty pounds ought and six, result misery." Last week, if the Bureau of Economic Analysis was to be believed, the American consumer seemed to be flirting with that miserable state Macawber warned against. Monday, the BEA announced that in the month of June, consumers supposedly spent 99.8 cents out of every after-tax dollar, which meant a savings rate of just 0.2%. While the estimate for the April-June quarter wasn't quite as meager0.6% -- it still looked distressing beside the 3.5 cents on the after-tax dollar people were setting aside as recently as 1994. The news prompted a New York Times editorial bemoaning the fact that "people are deciding not to save," together with much hand-wringing over the idea that they "see no need to save" because of the booming economy and stock market.

But actually, habits of thrift are still alive and well in America, or at least they're about as alive as they were a few years ago. When you count all cash income that goes to consumers, including income from capital gains, you find that the savings rate is about what it was in '94. The story tells you much about where the current consumption boom is coming from and where it may be going in the months to come.

It also tells you a lot about the way the Bureau of Economic Analysis (part of the Commerce Department) keeps track of the rate of saving. As BEA chief statistician Bob Parker readily told me last week, the recent estimates were meant to send a "signal" that analysts need to look beneath the surface to find out what's really going on.

The BEA defines saving pretty much the way the rest of us would: what's left over from after-tax income after you buy goods and services. So what you "save" isn't just the money that gets put into a passbook account. As long as you're using money that comes out of current income, saving also involves the purchase of stocks and bonds. On the other hand, when you sell a stock and buy a bank CD with the proceeds, that isn't saving; it's an asset shift. Of course, some of us like to think of the purchase of a home as an "investment," but the Bureau is having none of that. It considers this also a form of consumption, which it calculates according to an imputation method that basically assumes homeowners are paying monthly rent to themselves.

As a matter of fact, one distortion the BEA readily acknowledges is cars. When you buy a new car, you rarely pay the full price upfront, but the bureau assumes you do. Since new car buying was booming in June, that's one reason why the savings rate looked so low. BEA's Parker told me last week that this problem will eventually be fixed through the same imputation method used with housing, where the assumption will be that people are renting their cars to themselves.

So far, so good; but the real distortion can come in when consumers are taking a lot of capital gains. What happens is this: When somebody sells 1,000 shares and spends some portion of the money on some consumer good, the bureau's ledger book gets hit in two ways but not in the requisite three. The agency records a rise in his consumption and a decline in his after-tax income because of that pesky capital-gains tax. So on the surface, it looks as though he's saving less. But that's only because he isn't being credited with the extra income. (Coincidentally, BEA purged a piece of capital gains out of personal income numbers last week, which Bob Parker pointed out might have clued analysts into what's been going on.)
An arithmetical example illustrates the problem. Suppose somebody earns $100,000 and nets $70,000 after taxes, out of which he spends $60,000 and saves $10,000, for a savings rate of 14.3%. Then say he takes a $100,000 capital gain in the same year, out of which he pays a tax of $20,000, and that out of that $80,000 net proceeds, he buys a $30,000 diamond. Now, as far as the BEA is concerned, this person's income statement has turned into a mess. His after-tax income gets reduced to $50,000 from $70,000, because it's been clobbered by that additional $20,000 capital-gains tax. His consumption gets raised to $90,000 from $60,000 because of that diamond purchase.

Result: misery. From someone who used to save at the rate of 14.3% a year, he looks like a candidate for Debtors Anonymous. But that's only because we're forgetting the $80,000 extra that gave him the financial wherewithal to look so profligate in the first place. Regional Financial Associates chief economist Mark Zandi has found that the past few years' surge in capital gains is at the root of BEA's reporting that saving is on the wane. What's key is that the resulting increase in consumption is not due to what economists normally refer to as the "wealth effect." That particular phenomenon refers to people spending more because they feel wealthier; that is, they gaze happily on their paper profits in stocks, bonds, or homes and buy more things as a result. In that case, it would be quite accurate to say their saving has declined, since they'd be spending more out of the same income.

But in this case, we're talking about what might be dubbed the "windfall effect," in which people are spending more out of extra income. Zandi has found that these windfalls have not only come out of realized capital gains from stock market sales, but out of the cash realized through mortgage refinancings, which BEA also doesn't include in its accounting. What homeowners have been doing is borrowing more out of the appreciated value of their homes, which amounts to another kind of capital gain. Make a reasonable assumption for additional consumer buying out of all this money, throw in the effect on after-tax income, and you've pretty much accounted for the supposed decline in saving since 1994.

This isn't to say the wealth effect hasn't also been playing some role. But compared to the windfall effect, it's been relatively minor. As is his habit, the economist Zandi did a thorough statistical analysis of the supposed decline in the savings rate and came up with some intriguing results. To begin with, he found that the aging of the population since '94 has boosted the savings rate by about the same amount that the wealth effect has reduced it; in both cases, not very much. The real action has been elsewhere.

Our econometrician assumed that people consumed 25 cents of every dollar from capital gains and, based on a Federal Reserve study of the subject, 33 cents of every dollar from mortgage refinancing. On that basis, he's found that if the surge in these practices hadn't taken place over the past few years, the savings rate would barely have declined at all. All of which tells us something else. If the increase in volume is any guide, the recent gyrations in equity prices may be motivating more individual investors than ever before to do the prudent thing and cash in their chips. Some of them may be taking that long-awaited cruise with the money or paying for their child's college education. If so, then I wouldn't be surprised to find that, come the 28th of this month, the BEA reports that for maybe the first time in recorded history -- since 1946, to be precise -- consumer saving has gone negative. And I wouldn't worry about it, either.