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Executive Summary

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center for retirement research at boston college

WHY DON'T AMERICANS SAVE?

By Barry Bosworth

The U.S. household saving rate has undergone an astonishing collapse over the past two decades. The causes of the reduced saving rate are of particular interest as the nation looks ahead to the rising future costs of providing for the consumption needs of an aging population. If the drop in savings rate is transient in nature, or simply due to the recent rise in the wealth-income ratio, the savings rate should recover in future years. However, other more permanent sources of decline would have significant implications for future growth and the adequacy of retirement resources.
An examination of the macroeconomic trends in personal saving, using both the U.S. national accounts of the flow of funds accounts, reveals the following basic results:

- The decline in the overall rate of personal saving appears to have begun in the last half of the 1980s, the largest drop being in non-retirement saving, which fell to zero in the late 1980s and turned sharply negative after 1999.

- Retirement savings also fell steadily throughout the 1990s as a share of disposable income. Saving within pension funds and IRAs accounts for forty percent of the drop in the personal saving rate between the early 1980s and 2000-2003. A large portion of the decline of saving within the pension account is relatively permanent, and reflects a maturation of the overall retirement system.

- Both the flow of funds and the national accounts measures of saving show a very similar pattern of deterioration, eliminating the possibility that the savings decline is just a statistical illusion.

- When analyzing household saving trends, economists have also explored alternative definitions of saving, such as inclusion of consumer durables, inflation, and capital gains.

    - The inclusion of consumer durables has only a small impact on the estimated magnitude of the decline in savings arising from the standard measure that this study uses.

    - Including inflation as an alternative measure of saving does have an impact on the decline in saving. The inflation adjustment is quite large in the early 1980s, and declines by the end of the nineties. As a result, lower inflation is a potential explanation for some of the decline in the reported saving rate.

    - The treatment of capital gains is by far the most controversial issue when it comes to alternative saving measures. The inclusion of capital gains results in an extraordinarily volatile measure of saving at the aggregate level. For most purposes, the inclusion of capital gains does not yield a useful definition of either income or saving.

- Another alternative explanation of saving decline focuses on a presumed increase in the liquidity of the housing and mortgage markets. However, in early years the short-run fluctuations in this measure and the changes in the saving rate appear not to be correlated, and mortgage equity withdrawal appears to be too small to account for a significant portion of the saving decline.

Given the stability of the saving rate in the decades prior to 1980 and the one-time nature of the recent decline, macroeconomic data alone cannot fully account for the change. The Survey of Consumer Finances (SCF) was used to explore some of the microeconomic aspects of the saving decline. In order to obtain useful measures of saving, it was necessary to adjust the wealth measures of the SCF to the definitions of the flow of funds accounts (FFA) and adjust for capital gains and losses. The analysis focused on the survey intervals of 1983-1992 and 1992-2001.

For many components of wealth, the surveys are very similar to the corresponding aggregates of the FFAs. However, several adjustments to the SCF were required. First, when the capital gains are not removed from the household survey data, the magnitude of capital gain overwhelms the estimated rate of active saving. Thus, nothing can be said about active saving behavior without first adjusting for capital gains.

Second, the SCF measure of change in net worth rises substantially in the second period studied because of a large discrepancy between the SCF and FFA estimates of wealth in 2001. Nothing in the aggregate data would support this SCF statistic, and thus, errors in respondents' estimate of the value of their asset holding is the most plausible explanation.

If the errors in reported valuations are distributed relatively randomly across respondents, the SCF might still provide valuable information on the composition of the change in wealth. Therefore, the ratio of the nominal values of the FFAs to the SCF values within each asset category was used to adjust the SCF data at the level of individual respondents. This study included a comparison based on fixed points in the age distribution and individual age cohorts, and produced the following results:

- The combination of benchmarking the SCF data to the FFAs and the exclusion of capital gains provides evidence of reduced saving throughout the age distribution.

- The cohort classification shows a strong pattern of life-cycle saving – saving is highly positive for the middle-aged and turns negative after age 60.

- When saving behavior is analyzed on a per family basis, much of the prior evidence of substantial wealth decumulation among the older cohorts is removed.

- Each age cohort was also examined by years of education – divided by those with a high school education or less, and those with some tertiary education. The tabulations suggest that the more educated families in each cohort do account for a higher portion of the saving in their working years and more dissaving in their retirement years. However, there is no consistent difference between the saving of those with high and low education attainment in the shift to lower rates of saving after 1992.

- Additional tabulations used homeownership and income as the distinguishing characteristics, and were even less successful in yielding any differentiation in saving behavior, perhaps because they are less likely to define a stable group over time.

In summary, the decline in household saving that extends over the past two decades is evident in both the macro- and microeconomic data sets. The macroeconomic data shows a major portion of the fall in saving can be traced to lower rates of growth of pension plans. Saving outside of the formal retirement accounts has also declined significantly. The microeconomic cohort analysis suggests the decline in aggregate saving has been a relatively widespread phenomena that cannot be attributed to any limited category of households.

Most importantly, this study highlights the lack of a panel dimension in the SCF household data that would allow a more in-depth exploration of the sources of change in wealth holdings. The construction of synthetic cohorts does suggest a strong life-cycle pattern of saving, but provides only limited additional insights into the factors behind the decline in savings. The next big step in an analysis of household saving would be to extend the SCF to have a panel dimension.

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CENTER FOR RETIREMENT RESEARCH AT BOSTON COLLEGE

Fulton Hall 550, 140 Commonwealth Avenue, Chestnut Hill, MA 02467-3808
phone 617.552.1762 fax 617.552.1750 crr@bc.edu www.bc.edu/crr