

Saving, Wealth, Investment, and the Current-Account Deficit

In the national income and product accounts (NIPAs), personal saving as a percentage of disposable personal income has trended downward since peaking at 11.2 percent in 1982 (chart A). In 2004, the personal saving rate was 1.2 percent, or \$102.1 billion out of \$8,634.0 billion in disposable personal income.¹ The declining saving rate has spawned much concern among economists and policymakers about the consequences of such low saving, which, in the view of some, include reliance on unsustainable levels of external financing for the Nation's investment needs and increased exposure of domestic financial markets to external factors.

Personal saving is the portion of personal income that is not spent on current consumption but that is instead used to provide funds to capital markets or invested in real assets such as residences. It is a component of gross national saving, along with undistributed corporate profits (business saving), government saving, and consumption of fixed capital (a depreciation charge). Net national saving represents the amount of net income from current-period production that is left over after all consumption-related expenditures. This amount is available to finance net domestic investment in fixed capital assets (such as structures, equipment, and software) or in inventories. Economic growth and rising productivity are possible only with adequate levels of investment, and investment must be financed by saving from some source.

Capital gains and losses, which reflect changes in the prices of already existing assets, are excluded from the NIPA definition of saving. Clearly, unrealized capital gains provide no funds for investment. Realized capital gains are also not a source of fund-

ing for investment, because the funds that the seller adds to the pool of saving are offset by the funds that the buyer has withdrawn from that pool.

In contrast to the persistently downward trend of personal saving, in 2001–2004, saving by business grew strongly (table A). Saving by government fell; the fall exceeded the decline in personal saving. In aggregate, net national saving fell to 2.1 percent of national income in 2004 from a peak of 7.3 percent in 1998. However, net domestic investment rebounded from a cyclical trough in 2002 to a level near its 20-year average in 2004; therefore, the gap between U.S. saving and U.S. domestic investment widened. This gap was bridged by net national borrowing, which represents saving by the rest of the world that is used to finance domestic investment.² The excess of the Nation's spending over the Nation's income can also be measured by the current-account deficit, which equals the combined deficit with the rest of the world on trade, income, and current transfers.

The downward trend in personal saving in the NIPAs is confirmed by a measure of personal saving in the Federal Reserve Board's flow-of-funds accounts that is conceptually consistent with the NIPA measure (chart A). This measure estimates personal saving as the difference between net purchases of financial assets and real estate by persons, plus net amounts invested in business partnerships and sole proprietorships, less net increases in personal debt.

The decline in personal saving has led to much discussion of the "wealth effect," the tendency of consumers to spend more when their assets appreciate. In 2004, personal net worth rebounded to 5.6 times disposable personal income as a result of realized and unrealized capital gains on real estate, corporate equities, and mutual funds. Some of the capital gains on real estate in recent years have been used to support additional mortgage borrowing, which may have reduced personal saving, and some capital gains on pension plan assets have been used to pay pension benefits, which also may have reduced the NIPA measure of personal saving.³ The Bureau of Economic Analysis is working on integrated saving and wealth accounts that will include information on capital gains and losses.

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2. Net lending or net borrowing shown in NIPA table 5.1 includes net purchases of assets from the rest of the world; it is not limited to debt instruments.

3. The aging of plan participants has also contributed to the decline in saving by defined benefit pension plans; see Marshall B. Reinsdorf, "Alternative Measures of Personal Saving," SURVEY OF CURRENT BUSINESS 84 (September 2004): 17–27.

Chart A. Personal Saving Rate

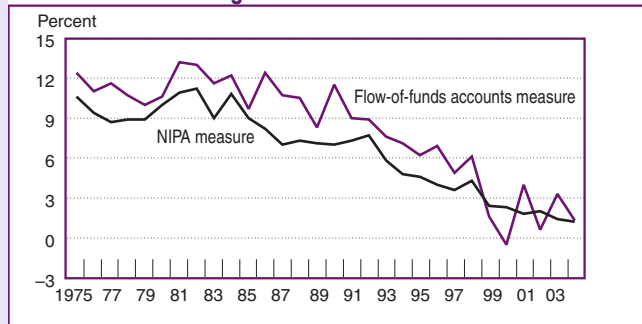


Table A. National Saving, Investment, and Borrowing

[As a percent of national income]

	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Personal saving (with accrued wages).....	6.9	5.8	6.0	5.9	5.9	6.2	6.4	5.0	4.4	4.1	3.4	3.0	3.6	2.0	1.9	1.5	1.7	1.1	1.0
Plus: Business saving.....	2.7	3.0	3.5	2.5	2.4	2.5	2.6	2.9	2.8	3.5	3.8	3.9	2.6	3.1	2.0	2.1	3.3	4.0	4.5
Equals: Net private saving.....	9.5	8.8	9.5	8.5	8.3	8.7	8.9	7.9	7.2	7.6	7.1	6.9	6.2	5.1	3.9	3.6	5.0	5.2	5.5
Plus: Net government saving.....	-4.4	-3.2	-2.6	-2.3	-3.2	-4.2	-5.4	-4.7	-3.3	-2.9	-1.7	-0.2	1.2	1.9	2.7	0.6	-3.0	-3.8	-3.5
Equals: Net national saving.....	5.2	5.6	7.0	6.2	5.1	4.6	3.6	3.2	3.9	4.7	5.5	6.7	7.3	7.0	6.6	4.2	2.0	1.4	2.1
Net national saving plus statistical discrepancy.....	6.4	6.1	6.5	7.0	6.4	5.9	5.4	5.6	6.2	6.3	6.8	7.6	7.1	6.5	5.2	3.2	1.8	1.6	2.6
Less: Net domestic investment.....	10.0	9.8	9.0	8.9	7.7	5.7	6.1	6.9	7.9	7.7	8.3	9.2	9.6	9.8	9.7	7.3	6.7	6.9	8.7
Equals: Balance on current account.....	-3.6	-3.6	-2.5	-1.8	-1.4	0.3	-0.7	-1.2	-1.7	-1.4	-1.5	-1.5	-2.4	-3.3	-4.5	-4.1	-5.0	-5.3	-6.2
Less: Capital-account transactions.....	0.0	0.0	0.0	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0
Equals: Net lending or net borrowing (-).....	-3.6	-3.6	-2.5	-1.8	-1.5	0.2	-0.7	-1.2	-1.7	-1.4	-1.5	-1.5	-2.4	-3.4	-4.5	-4.1	-5.0	-5.3	-6.2