After Janel Ward starts collecting her salary as a doctor, she’ll still drive her ’98 Buick with its cracked windshield. Her family will still live in their modest townhouse in Denver. And for years to come, those big paychecks won’t go toward vacations or nights out, but paying bills—still.

When Ward graduates from the University of Colorado’s School of Medicine this year, she will have accumulated more than $200,000 in student loans.

“It’s pretty scary,” she says. “But, if I want this career, I have to have this debt.”

For Ward, and many of her fellow med students, this means costs have to be cut. Life’s luxuries are out of reach. Building a nest egg must wait.

But they hope not for long. Their anticipated annual salary, usually in the hundreds of thousands, makes the debt incurred early in life an easier pill to swallow, they say.

It’s this behavior—when households rationally plan spending based on expected income and assets—that illustrates why the decline in the country’s personal saving rate may not be as alarming as is often portrayed, says Alan Garner, an assistant vice president and economist at the Federal Reserve Bank of Kansas City.

Data show for the last two decades, Americans’ personal saving has been steadily dwindling and has dropped to a negative rate. While Garner acknowledges many Americans aren’t saving adequately for long-term needs, he says
this current-spending-based-on-future-income theory suggests the low saving rate may not be as dire as initially stated.

Additionally, there may have been various measurement problems with the most recent saving rate calculations. Recognizing these factors can reduce concern about Americans’ well-being and the nation’s economy.

“The low personal saving rate may not foreshadow wrenching future adjustments in consumer spending,” Garner says.

A penny saved

The most commonly cited measure of personal saving is calculated from the national income and product accounts, or NIPA, from the U.S. Department of Commerce. It measures the funds taken out of current household income (after taxes) and saved, not including capital gains or losses on existing assets.

Personal saving has plummeted from about 10 percent of disposable income in the 1980s to 2 percent in 2004. But by 2005, the saving rate turned negative for the first time since the Great Depression, falling to -0.4 percent.

“The downward trend in the personal saving rate has prompted expressions of concern by economists and other observers,” Garner says. “Underlying these and virtually every other discussion of saving trends is one point of agreement: Saving for the future is important.”

Much of the concern about the low saving rate stems from the aging population’s burden on health care and retirement systems. Projected population aging during the next 25 years creates unfunded Social Security and Medicare liabilities. Adding to the health care burden, medical costs are climbing faster than inflation.

Additionally, the decline in saving eventually might prompt a sudden increase in saving, effectively reducing growth of consumer spending, and in turn, real output and employment.

The purpose of saving is to increase resources for future use, Garner says, whether it’s for vacations, retirement or unexpected loss, such as an illness or job layoff. Typically, savings are invested in financial assets—bank accounts, mutual funds or real estate.

“Today’s saving influences future consumption because investments in financial assets are channeled into productive investments in factories, industrial...
machinery, computers and other kinds of capital,” Garner says.

Increased saving could help reduce these burdens by raising the domestic capital stock and increasing workers’ output. This would lead to higher earnings and make it easier to pay higher social insurance taxes if needed in the future to support Social Security and Medicare, he says.

**Explaining the drop**

Many explanations for the saving decline have been suggested, such as overspending and increased access to credit. However, Garner says much of the debate considers wealth effects on spending.

“Modern economic thought suggests saving and consumption depend on expectations about the future—expected future income or expected returns on stocks, bonds and other investments,” Garner says. “Thus, economists assume current consumption and saving depend on expected future resources as well as current resources.”

Right or wrong, this is the way Americans live, agrees Eric Seff, of Seff Investments Inc. in Albuquerque, N.M.

Seff is a long-time financial planner, specializing in spending- and investment-program development for his clients, who most often come to him for help tackling their debt, whether it’s from student loans or spending beyond their means.

This concept of spending now because you will earn later has at least one major risk: “Emergencies do come up,” Seff says, “whether it’s a broken furnace or something medical. There’s no cushion. There’s nothing there at all.”

However, economists traditionally have believed permanent-income and life-cycle views of consumption imply a dependable relationship between wealth and consumption for the economy as a whole.

Estimated life-cycle consumption implies a $1 increase in household net worth raises consumption by about 3 cents. Recent increases in

the stock market and home equity may have raised consumption relative to current disposable income and lowered the measured saving rate. Some argue that the overall decline in the personal saving rate since the mid-1980s is the result of capital gains on corporate stocks.

Estimates of the wealth effect on consumption are difficult to pin down empirically, Garner says.

**Should we worry?**

Although the personal saving rate may be revised upward in the coming years as data are further analyzed, the revisions would have to be exceptionally large to eliminate this downward trend, Garner says.

One factor in assessing the severity of the situation is the rising net worth of U.S. households, which is a sharp contrast to declining saving. Recent data estimate assets of households
There are several issues in measuring the rate of Americans’ personal saving that may alter its current—and negative—estimate, says Alan Garner, assistant vice president and economist at the Federal Reserve Bank of Kansas City. Coupled with rising net worth and expected income, revised calculations might mean the rate isn’t as alarming as initially thought.

However, alternative measures of the national income and product accounts, or NIPA, saving rate generally do not eliminate the downward trend, Garner cautions.

For example, counting purchases of consumer durables as a form of saving raises the personal saving rate but it doesn’t eliminate the downward trend. Neither does adding federal taxes on capital gains back into disposable income.

But possible future revisions, even if they are small, may gradually raise the saving rate. This has happened in the past, often decades later, and the revision can be substantial.

Published estimates from 1965 to 1999 were revised upward by about 2.8 percent. For the fourth quarter of 1981, the upward revision was 7.3 percent; the average revision for 1980-84 was 5.1 percent.

Garner says there is some evidence the NIPA revision might raise the personal saving rate. It is possible personal consumption expenditures may have been overstated, or income understated, which could return the personal saving rate to a positive—but still low—value.

Not so bleak

Sam Ceridon has lived a financially disciplined life, always budgeting and religiously saving for his golden years. Until now.

In fact, he’s spent all the money—plus some—that he’d put away during his three most-frugal years working as an engineer, and has even cashed in his retirement fund.

As in Janel Ward’s case, it’s all gone toward tuition, but it’s barely made a dent. Ceridon, only halfway through medical school at the University of Colorado, estimates his debt at $180,000. For someone who never carries a credit card balance, it’s “terrifying,” he says.

Rather than think of his debt as a
MED STUDENT SAM CERIDON is willing to go into debt now and assumes his future salary as a physician will pay it off quickly.

Should the decline in the Personal Saving rate Be a cause for concern?
By C. Alan Garner

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