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Introduction to U.S. Economy: Personal Saving

Personal saving, which includes the saving of households but not of businesses or government, can have a significant impact at both the individual and economy-wide levels in the long and short terms.

Economic Considerations

The saving rate, which is the ratio of total personal savings to disposable income, presents a tradeoff between current and future consumption. A relatively low saving rate implies higher current consumption but lower future consumption. Greater present consumption supplies individuals now; however, it leaves little to be invested in capital projects that will boost future living standards. Conversely, a relatively high saving rate implies lower current consumption but higher future consumption. This tradeoff has implications for both short-term and long-term economic growth.

Short-Term Economic Impacts

In the short term, a rising personal saving rate can be a temporary impediment to economic activity, assuming no other changes to income. If on average individuals begin saving a larger portion of their paychecks, it means less money is being spent on consumer goods and services in the economy. Because consumer spending makes up about 70% of the U.S. economy, even a small decrease in consumer spending can reduce aggregate demand and economic activity. Alternatively, a falling saving rate may result in temporarily faster economic growth as individuals spend a larger portion of their pay on goods and services.

A rise in the saving rate during an economic downturn can be problematic. In response to a recession, individuals may rationally respond to increased uncertainty about their future income by increasing their saving rate to protect them from potential job loss or reduced income in the near future. As a result, however, the economic downturn is further exacerbated due to the additional decrease in consumer spending resulting from the rising saving rate. By contrast, in the midst of a healthy and expanding economy, a rising saving rate may result in a more sustainable level of consumer spending, thus preventing the economy from overheating. An overheating economy occurs when demand for goods and services exceeds the economy's ability to produce those goods and services, which is often characterized by accelerating inflation followed by a recession.

Long-Term Economic Impacts

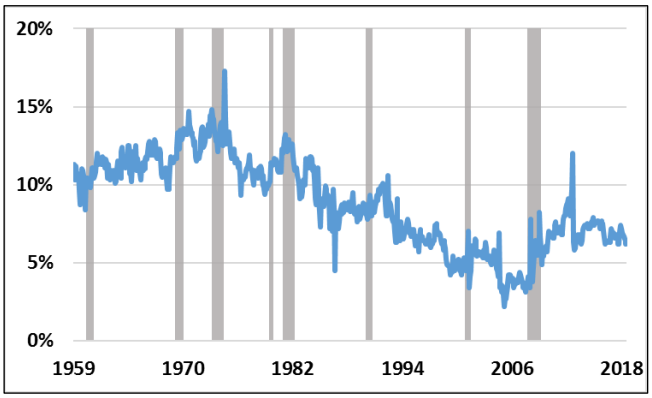
In the long term, however, a higher saving rate will generally lead to higher levels of economic output, up to a point. When individuals save a portion of their income, those saved funds are generally loaned out to businesses to finance new investments. For example, an individual's 401(k) is a saving vehicle for their future consumption after retirement, but before retirement, those funds are generally invested in various companies through the purchase of stocks and bonds.

The overall level of investment is one of the main determinants of long-term economic growth. Business investments in physical capital (i.e., machinery, buildings, and factories) allow the economy to produce more goods and services with the same amount of labor or raw materials, increasing the productive capacity of the economy. As such, all else equal, a higher saving rate will result in a higher level of physical capital over time, allowing the economy to produce more goods and services. For further information on business investment, refer to CRS In Focus IF11020, *Introduction to the U.S. Economy: Business Investment*.

How is Personal Saving Measured?

Economists generally track economy-wide saving via the personal saving rate (see **Figure 1**).

Figure 1. Personal Saving Rate



Source: Bureau of Economic Analysis

Notes: Ratio of total personal saving to total disposable income in the United States. Grey bars represent recessions.

Since the early 1970s, the U.S. personal saving rate has fallen from above 12% to a low of 1.9% in 2005. Following the beginning of the 2007-2009 recession, the saving rate briefly increased before beginning to fall again. Over the past year, the saving rate has averaged about 6.7%, suggesting that for every $100 of disposable income individuals are spending about $93.30 and only saving about $6.70.

The personal saving rate produced by the Bureau of Economic Analysis (BEA) is measured as the difference between aggregate income and consumption spending,

which likely introduces some measurement error into the indicator. The saving rate may understate the level of saving in the economy because certain spending is considered consumption spending, even though such spending is conventionally thought of as investment, such as spending on durable consumer goods (e.g., automobiles, appliances). Additionally, BEA does not include changes in asset prices or capital gains as income under the saving rate measure.

Alternative measures also show that many households are struggling to save any portion of their income. According to the Federal Reserve, in 2016, about 47% of adults reported saving some portion of their income over the past 12 months, whereas 31% of adults reported their income was equal to their spending, and 16% reported spending more than they earned. Additionally, saving varies dramatically based on income level, as shown in **Table 1**. Among families with an income in the bottom 20th percentile, less than one-third of families saved any portion of their income. Among families with an income in the top 10th percentile, about 82% of families saved some portion of their income.

Table 1. Family Saving by Income Level, 2016

Percentile of Income	Median Income (Thousands)	Families That Save (Percent)
Less than 20	15.2	32.1
20–39.9	31.4	45.2
40–59.9	52.7	57.2
60–79.9	86.1	64.9
80–89.9	136.7	72.5
90–100	260.2	82.3

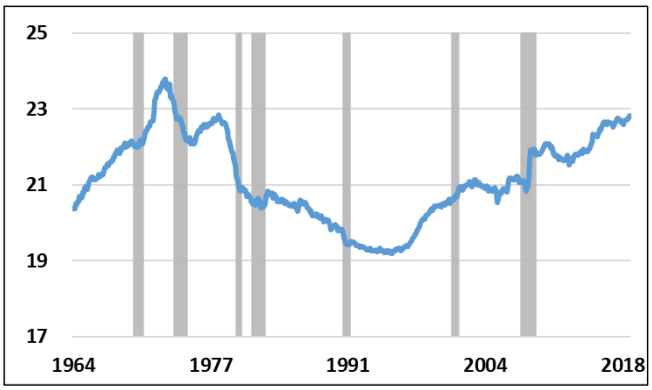
Source: Federal Reserve, Survey of Consumer Finances, 2016.
Notes: Income percentiles based on total family income.

Declining Saving Rate

Economists posit a number of reasons for the decline in saving. The most prominent explanation involves the increase in asset prices, including the stock market and housing prices since the mid-1980s. The overall increase in value of the stock market and housing prices increased the net wealth of households holding these assets. The increase in wealth tends to lead to increased consumption spending by households, driving down the personal saving rate. However, not all households own homes or financial assets.

An alternative explanation for the declining saving rate involves an increase in access to consumer credit over the past several decades. As access to credit increases, individuals generally increase their consumption, taking on debt to finance those purchases. This increase in consumption spending has not been fully matched by an increase in disposable income, leading to a decline in the saving rate.

Figure 2. Average Real Hourly Earnings
Production and Non-Supervisory Employees



Source: CRS calculations using data from Bureau of Labor Statistics
Notes: 2018 Dollars. Adjusted for inflation using the Consumer Price Index. Grey bars denote recessions.

In addition, according to some measures, real (i.e., inflation-adjusted) wages for non-managers fell between the mid-1970s and the mid-1990s, as shown in **Figure 2**. In the face of falling real wages and purchasing power, some families may have reduced the proportion of each paycheck they saved to maintain their lifestyle and consumption patterns. The decline in real wages may have resulted in some of the decline in the saving rate, though the increase in wages since the mid-1990s has not been accompanied by a return to the peak saving rate of the 1970s.

Foreign Investment Inflows

Following the declining U.S. personal saving rate, net national saving and investment (as percentages of GDP) have also been in decline over the past few decades. Net national saving includes all personal, business, and government savings. Net national investment includes all investment in capital goods and services, less depreciation. U.S. net national investment tends to exceed net national saving, due to investment inflows from abroad. Investment inflows from abroad likely support higher levels of investment and economic activity in the United States than would be possible using domestic saving exclusively.

However, these investment inflows from abroad have implications for aggregate income within the United States. Investments generate income streams for those who make the investment. When investments are made from abroad, the income generated from those investments are paid to individuals abroad, whereas when investments are made by individuals inside the United States, the income generated is paid to individuals in the United States. As such, a higher share of investment from abroad, while supporting economic activity inside the United States just the same as domestic investment, results in a higher share of the income generated within the United States being distributed abroad.

(*Note*: This In Focus was originally authored by Jeffrey Stupak, former CRS Analyst in Macroeconomic Policy.)

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