

The negative saving rate

The personal saving rate in the United States has been declining for decades; since 2005, it has been negative. This trend suggests increased personal debt and lower living standards in the long run. In a recent study in the Federal Reserve Bank of New York's *Current Issues in Economics and Finance* (May 2007), Charles Steindel examines some of the factors contributing to the decline in personal saving, as well as some of its feared results.

Steindel begins by explaining the *life cycle–permanent income model*. According to the model, people effectively project their real-dollar income over their entire lifetime, borrowing when they are young, saving during their most productive working years, and consuming saved assets when they are retired. Thus, a persistent decline in saving could negatively impact household well-being in the future. But Steindel argues that “increases in wealth (assets such as stocks and houses, less debt) relative to disposable income” over the last several decades might have “worked to boost spending relative to income,” thus reducing the personal saving rate. He further notes that if households predict that their permanent (future) income greatly exceeds their current (disposable) income, they might choose to save less now, counting on their ability to save more later.

Steindel notes that the data from the Bureau of Economic Analysis are preliminary. In the 1970s, early readings of reduced personal saving were later revised upward. Thus, the recent declines could be reversed later. Also, he attributes some of the recent decline in saving to the surge in energy prices in 2005 and 2006. Steindel broadens the definition of saving to include share repurchases paid to stockholders and constructs

a measure of “gross saving” that includes personal saving, undistributed corporate profits, depreciation, and government saving. By this measure, saving actually increased slightly during the past decade. Aggregate household wealth increased as well. Overall, Steindel finds little evidence to support the notion that the current low personal saving rate will jeopardize the future economic well-being of U.S. households.

The rise in the highest incomes

Much has been written about the increase in recent decades in the inequality of the income distribution in the United States. What is behind the rise in the incomes of those at the very top of the distribution?

In “Wall Street and Main Street: What Contributes to the Rise in the Highest Incomes?” (NBER Working Paper 13270), Steven N. Kaplan and Joshua Rauh of the Graduate School of Business at the University of Chicago consider this question. They look at four groups of highly compensated individuals: top executives of firms that are not in the finance sector; financial service sector employees from investment banks and fund companies; lawyers; and professional athletes and celebrities. Kaplan and Rauh refer to the first and second groups, for short, as “Main Street” and “Wall Street.”

Their evidence indicates that these four groups account for somewhere between 15.0 percent to 26.5 percent of those who make up the very highest adjusted gross income categories (such as the top 0.1 percent, 0.01 percent and so on). The researchers believe that their assumptions are conservative and that these groups may represent even larger fractions of

these categories.

According to Kaplan and Rauh, their evidence provides support for three theories about the increase in inequality. One is the theory of skill-based technological change, which “predicts that inequality will increase if technological progress raises the productivity of skilled workers relative to unskilled workers and/or raises the price of goods made by skilled workers relative to those made by unskilled workers.” As an example, they mention that computers and related advances in technology may complement skilled labor (and also substitute for unskilled labor). The complementary relationship may help to explain pay gains of professional athletes, who are able to reach more consumers because of technology, and Wall Street investors, who can acquire information and trade large amounts more efficiently.

A second theory involves the scale of companies. Dramatically increased revenues may help explain the higher compensation of some employees. A third theory is what has been called the “superstar” theory. As Kaplan and Rauh put it, this theory, first introduced by Sherwin Rosen, “can be viewed as a combination of the previous two explanations in that the individuals and firms who benefit from the technological change are likely to get larger.” □

We are interested in your feedback on this column. Please let us know what you have found most interesting and what essential readings we may have missed. Write to: Executive Editor, *Monthly Labor Review*, Bureau of Labor Statistics, Washington, DC 20212, or e-mail, mlr@bls.gov