Where Has All the Saving Gone?

by Anthony M. Carilli

Social commentators from both ends of the political spectrum have long bemoaned the low rate of saving in the United States. They fear that the lowest rate of saving in the industrialized world portends economic disaster. The level of saving is one factor that determines the level of interest rates: the lower the rate of saving, the higher the interest rate. The interest rate is the price of obtaining funds for investment. So, high interest rates yield lower levels of investment. Thus a relatively low rate of saving yields a relatively low rate of investment. The low level of investment makes it difficult for American enterprise to compete in the world market, because it will be unable to afford the adoption of new technologies.

Some blame the low rate of saving on American materialism. Some say that Americans do not have a moral commitment to saving. Still others blame the shortsighted selfishness of the market economy for the paucity of saving. The solution, the social commentators argue, is to change the psychology of the American consumers.

These criticisms and their requisite solutions miss entirely the true reason for the low rate of saving in the United States. Americans are rational decision makers. They weigh costs against benefits to decide upon how much to consume and how much to save. The decision to save is an economic decision. Most consumers place a higher value on near-term consumption than on consumption in the distant future. To get people to give up the bird in the hand for the two in the bush, interest must be paid. The higher the interest rate the more likely an individual is to put consumption off; that is, the higher the interest rate the more likely it is that the individual will save. Although consumers save for a variety of reasons—to provide for retirement, to leave legacies for their children, to provide for random emergencies—the decision to save is based on economic incentives.

In a free market, consumers purchase various bundles of goods according to the relative prices of those goods. The saving choice is one of choosing relative amounts of present and future consumption. The price of present consumption in terms of future consumption is the interest rate. Thus, consumers substitute future for present consumption as the interest rate rises (i.e., as the price of present consumption rises, *ceteris paribus).* So increases in interest rates will tend to bring about increases in saving.

Punishing Thrift

Given that consumers are rational, why is the U.S. saving rate consistently as low as it is? U.S. economic policy toward saving is the answer. Policies over the last 50 years not only have not encouraged but have actually discouraged saving. The question is then: why discourage saving? The answer lies in the economic policies based upon the economic theories of John Maynard Keynes.

A legacy of the Keynesian revolution is that the venerable Benjamin Franklin's aphorism "A penny saved is a penny earned" now reads "A penny saved is a penny *destroyed.*" Saving, to Keynes,

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except at full employment, is not only unwise but invidious: "[W]henever you save five shillings, you put a man out of work for a day."[1] Parsimony is bad and prodigality is good according to Keynes. It does not matter how income is spent so long as income is *not* saved.

> For example, why not pull down the whole of South London from Westminster to Greenwich, and make a job of it—housing on that convenient area near to their work a much greater population than at present, in far better buildings with all the conveniences of modern life, yet at the same time providing hundreds of acres of squares and avenues, parks and public spaces, having, when it was finished, something magnificent to the eye, yet useful and convenient to human life as a monument to our age? Would that employ men? Why of course it would![2]

To Keynes, destruction is production. Using this logic, it would make sense to bomb some part of every major city every year to "create" jobs.

Spending is preferred to saving even when the spending is done "[t]o dig holes in the ground."[3] This hole digging "will increase, not only employment, but the real dividend of useful goods and services."[4] The prodigal son is the economic hero while the parsimonious son is the economic villain.

The Paradox of Thrift

This inversion of Christian values manifests itself in the paradox of thrift. Children are taught to save for a rainy day; to exercise discipline from the earliest possible age. According to the paradox of thrift, this discipline is strangely a vice if it is practiced by all "children" simultaneously. The aphorism "save for a rainy day" is merely a euphemism for "be prepared for those times when income is tight or nonexistent." The paradox of thrift teaches that the best way to be prepared for this unenviable situation is not to prepare for it at all. To the contrary, the best preparation is not that of accumulating income to mitigate the possible hardships, but to consume as much as possible. "For what we need now is not to button up our waistcoats tight, but . . . to buy things."[5] The rational act of preparing for the exigencies consistent with an economic slump will actually hasten the arrival of the downturn. Insurance against disaster will ultimately destroy the wealth of the family. The accumulation of wealth is the destruction of wealth according to the paradox of thrift.

The message is clear: saving is to be avoided despite the fact that saving is almost an instinctive act of man. In this regard, man behaves like many animals. Just as the squirrel stores nuts for the winter, man places part of his current supply of food (income) aside for future meals (spending). Man differs from the squirrel in one respect, however. Man can invest. Man can create larger future harvests by investing part of the seed corn to grow more corn for next year. Without this investment, man does not increase the size of his meal (i.e., his standard of living). If man and the squirrel do not provide for the future, they do not survive the future. So saving *is* important for man as well as animals. In this regard the paradox of thrift is unnatural. It teaches that not only shouldn't families save, but that they should run down their existing savings (should they be so villainous as to have any) even if it is spent to dig holes in the ground.

Keynes' War on Saving

Keynes worried that some may not be convinced of the efficacy of these arguments. Keynes also understood the relationship between interest rates and saving, so to reduce the incentive to save further, he advocated policies be undertaken to drive the interest rate to zero. In fact, "[i]f the rate of interest were zero, there would be an optimum interval for any given article between the average date of input and the date of consumption for which labour cost would be a minimum."[6] A zero rate of interest will have "beneficial" effects upon the community as well. "Change and progress would result only from changes in techniques, taste, population and institutions . . . [f]or a little reflection will show what enormous social changes would result from a gradual disappearance of a rate of return on accumulated wealth."[7] This optimum state could be brought about in a "*properly run* [italics mine] community . . . within a single generation."[8] Thus, Keynes was not only concerned with eradicating man's instinct to save, but also he was concerned with bringing about a centrally planned economy.

Further, Keynes argued that saving needs also to be discouraged because "[a]n act of individual saving means so-to-speak a decision not to have

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dinner to-day. But it does not necessitate a decision to consume anything at any specified date."[9] Keynes did not view saving as a decision to substitute future consumption for present consumption. There is nothing else that saving can be used for except future consumption. So, never mind that most saving is done in anticipation of future consumption. "In the long run, we are all dead."

The U.S. economy may now be in Keynes' fabled long run. Economic policy makers took Keynes' aversion to saving to heart. Anti-saving policies have proliferated to the point where no motive for saving goes unpunished. Social Security encourages individuals not to save for their retirements. Saving for medical emergencies is discouraged through programs such as Medicare and Medicaid. There is sentiment on the national level for national health care and catastrophic health care. This will not only discourage saving for such unforeseen expenses; it will reduce disposable income available for saving. Government must first take (tax) before it can spend. Further, if Congress is successful in its attempt to have businesses pick up the tab for national health insurance, wages will fall (or at least the rate of growth of wages will fall). Unemployment "insurance" makes fatuous the reason for saving to withstand any short term job loss. Finally, the return on saving (interest income) is taxed at progressive marginal rates. Government policy toward saving is one of discouragement, *per se.*

The taxation of interest income may well be the most effective instrument for discouraging saving. Suppose that there were no tax on income or goods and that an individual's hourly wage were $10. If his future earnings were to remain the same and he would want to consume $10 more annually, he would need to work an additional ten hours, if the interest rate were 10 percent. Now suppose there is a 50 percent tax on income; he would have to earn $400 to be able to consume $10 more annually. That is, the income tax quadrupled the price of saving. (He earns $400 and pays a tax of $200 leaving him with $200 to save. The $200 earns $20 interest, leaving him with $10 after taxes.) The effective interest rate is only one quarter of the nominal interest rate. At this price very few people will save.

Thus, as the United States begins its journey through the last decade of the 20th century, various commentators are bemused by the paucity of saving by the American people. Given the hidden and largely malevolent attitude harbored by policy makers toward saving, is there really any question as to why this (the low rate of saving) is true? It is as if policies toward saving have been the cruel joke of some "[p]ractical men . . . [m]admen in authority, who hear voices in the air . . . distilling their frenzy from some academic scribbler of a few years back."[10] Thus, one sees that "it is ideas . . . which are dangerous for . . . evil."[11] The reasons for the low rate of saving are not necessarily psychological, moral, or inherent in the market economy. Quite the contrary: The low rate of saving is the direct result of economic policy over the past 50 years. If we truly want to increase the rate of saving, the solution is to stop enticing people not to save and to stop penalizing them when they do. □

1. John Maynard Keynes, *Essays in Persuasion* (New York: W. W. Norton & Company, 1963), p. 152.
2. *Ibid.*, pp. 153-154.
3. John Maynard Keynes, *The General Theory of Employment, Interest and Money* (New York: Harcourt Brace Jovanovich, 1964), p. 220.
4. *Ibid.*
5. Keynes, *Essays in Persuasion*, pp. 152-153.
6. Keynes, *The General Theory of Employment, Interest and Money* p. 216.
7. *Ibid.*, pp. 220-21.
8. *Ibid.*, p. 220.
9. *Ibid.*, p. 210.
10. *Ibid.*, p. 383.
11. *Ibid.*, p. 384.

Memoirs of a Simple Honorable Man

by Charles H. Hamilton

I don't know if John Chamberlain ever reviewed Conrad Richter's *A Simple Honorable Man*, but he should have. No one who has ever met John can doubt that he embodies these rare qualities. Any era has only a few such souls. They remind us that, above all else, the characteristic of simple common decency makes for a better, and freer, world.

The Turnabout Years: America's Cultural Life, 1900-1950
by John Chamberlain
Foreword by Priscilla Buckley
Jameson Books, Inc., P.O. Box 738, Ottawa, Illinois 61350 • 1992 • 272 pages
$12.95 paperback.

Readers of *The Freeman* know John's monthly book review column, "A Reviewer's Notebook." It has been a staple since FEE began publishing *The Freeman* in 1954. He missed the first issue in July of that year but continues his column today—though not on the same rigorous monthly schedule he maintained for nearly 35 years! Thus, it would be an easy mistake to take John for granted, or to think of him only in his important role as "our" *Freeman* reviewer.

The reviews in this new collection are from an earlier *Freeman*, the immediate predecessor of FEE's publication. It was published between October 2, 1950, and June 28, 1954, though John wrote for it during only the first half of its short life. The 54 reviews in this book come from those 61 issues. There is also one new piece on "The Basic John Dos Passos." They afford us the opportunity to remind ourselves of John Chamberlain's outstanding reaffirmation of the voluntarist spirit.

John Chamberlain has read a remarkable number of books in 89 years; one suspects he was born reading a book (on October 28, 1903). By one count he has published over 20,000 essays and reviews. Looking back from today, we see that in addition to *The Freeman*, John had a widely featured three-times-a week syndicated column from 1960 until 1990. Prior to that he had been an editorial page writer for *The Wall Street Journal* from 1950 to 1960. He had a long association with *Life*, first in Washington from 1941 to 1945, then as an editor from 1945 to 1950, and later as their chief editorial writer in the late 1950s. He had earlier been an editor at *Fortune*, writing editorials, feature articles, and business studies from 1936 until 1941.

These steady jobs were peppered with additional, often overlapping, stints. For instance, he was a senior editor and lead reviewer for *National Review* at its beginning in 1955. He worked for *Barron's* as an associate editor before that. He was a book review editor for *Harper's* from 1939 to 1947, a book review editor at *Scribner's* from 1936 to 1938, and briefly associate editor of *Saturday Review* in 1932.

John's career began when journalism was a more intellectual profession. He started at *The New York Times* in 1926 and became assistant editor of *The New York Times Book Review* in 1928. He became the first daily book reviewer for the *Times* in 1932 and continued for over four

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