NO MORE SAVINGS!

THE CASE FOR SOCIAL WEALTH

BY ELLEN FRANK

Pundits from the political left and right don’t agree about war in Iraq, gay marriage, national energy policy, tax breaks, free trade, or much else. But they do agree on one thing: Americans don’t save enough. The reasons are hotly disputed. Right-wingers contend that the tax code rewards spenders and punishes savers. Liberals argue that working families earn too little to save. Environmentalists complain of a work-spend rat race fueled by relentless advertising. But the bottom line seems beyond dispute.

Data on wealth-holding reveal that few Americans possess adequate wealth to finance a comfortable retirement. Virtually none have cash sufficient to survive an extended bout of unemployment. Only a handful of very affluent households could pay for health care if their insurance lapses, cover nursing costs if they became disabled, or see their children through college without piling up student loans. Wealth is so heavily concentrated at the very top of the income distribution that even upper-middle class households are dangerously exposed to the vagaries of life and the economy.

With low savings and inadequate personal wealth identified as the problem, the solutions seem so clear as to rally wide bipartisan support: Provide tax credits for savings. Encourage employers to establish workplace savings plans. Educate people about family budgeting and financial investing. Promote home ownership so people can build home equity. Develop tax-favored plans to pay for college, retirement, and medical needs. More leftish proposals urge the government to redistribute wealth through federally sponsored “children’s development accounts” or “American stakeholder accounts,” so that Americans at all income levels can, as the Demos-USA website puts it, “enjoy the security and benefits that come with owning assets.”

But such policies fail to address the paradoxical role savings play in market economies. Furthermore, looking at economic security solely through the lens of personal finance deflects focus away from a better, more direct, and far more reliable way to ensure Americans’ well-being: promoting social wealth.

THE PARADOX OF THRIFT

Savings is most usefully envisaged as a physical concept. Each year businesses turn out automobiles, computers, lumber, and steel. Households (or consumers) buy much, but not all, of this output. The goods and services they leave behind represent the economy’s savings.

Economics students are encouraged to visualize the economy as a metaphorical plumbing system through which goods and money flow. Firms produce goods, which flow through the marketplace and are sold for money. The money flows into peoples’ pockets as income, which flows back into the marketplace as demand for goods. Savings represent a leak in the economic plumbing. If other purchasers don’t step up and buy the output that thrifty consumers shun, firms lay off workers and curb production, for there is no profit in making goods that people don’t want to buy.

On the other hand, whatever consumers buy is available for businesses to purchase in order to expand their capacity. When banks buy computers or developers buy lumber and steel, then the excess goods find a market and production continues apace. Economists refer to business purchases of new plant and equipment as “investment.” In the plumbing metaphor, investment is an injection—an additional flow of spending into the economy to offset the leaks caused by household saving.

During the industrial revolution, intense competition meant that whatever goods households did not buy or could not afford would be snatched up by emerging businesses, at least much of the time. By the turn of the 20th century, however, low-paid consumers had become a drag on economic growth. Small entrepreneurial businesses gave way to immense monopolistic firms like U.S. Steel and Standard Oil whose profits vastly exceeded what they could spend on expansion. Indeed expansion often looked pointless since, given the low level of household spending, the only buyers for their output were other businesses, who themselves faced the same dilemma.

As market economies matured, savings became a source of economic stagnation. Even the conspicuous consumption of Gilded Age business owners couldn’t provide enough demand for the goods churned out of large industrial factories. Henry Ford was the first American corporate leader to deliberately pay his workers above-market wages,

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reasoning correctly that a better-paid work force would provide the only reliable market for his automobiles.

Today, thanks to democratic suffrage, labor unions, social welfare programs, and a generally more egalitarian culture, wages are far higher in industrialized economies than they were a century ago; wage and salary earners now secure nearly four-fifths of national income. And thrift seems a quaint virtue of our bemighted grandparents. In the United States, the personal savings rate—the percentage of income flowing to households that they did not spend—fell to 1% in the late 1990s. Today, with a stagnant economy making consumers more cautious, the personal savings rate has risen—but only to around 4%.

Because working households consume virtually every penny they earn, goods and services produced are very likely to find buyers and continue to be produced. This is an important reason why the United States and Europe no longer experience the devastating depressions that beset industrialized countries prior to World War II.

Yet there is a surprisingly broad consensus that these low savings are a bad thing. Americans are often chastised for their lack of thrift, their failure to provide for themselves financially, their rash and excessive borrowing. Politicians and economists constantly exhort Americans to save more and devise endless schemes to induce them to do so.

At the same time, Americans also face relentless pressure to spend. After September 11, President Bush told the public they could best serve their country by continuing to shop. In the media, economic experts bemoan declines in “consumer confidence” and applaud reports of buoyant retail or auto sales. The U.S. economy, we are told, is a consumer economy—our spendthrift ways and shop-till-you-drop culture the motor that propels it. Free-spending consumers armed with multiple credit cards keep the stores hopping, the restaurants full, and the factories humming.

Our schizophrenic outlook on saving and spending has two roots. First, the idea of saving meshes seamlessly with a conservative ideological outlook. In what author George Lakoff calls the “strict-father morality” that informs conservative Republican politics, abstinence, thrift, self-reliance, and competitive individualism are moral virtues. Institutions that discourage saving—like Social Security, unemployment insurance, government health programs, state-funded student aid—are by definition socialistic and result in an immoral reliance on others. Former Treasury Secretary Paul O’Neill bluntly expressed this idea to a reporter for the Financial Times in 2001. “Able-bodied adults,” O’Neill opined, “should save enough on a regular basis so that they can provide for their own retirement and for that matter for their health and medical needs.” Otherwise, he continued, elderly people are just “dumping their problems on the broader society.”

This ideological position, which is widely but not deeply shared among U.S. voters, receives financial and political support from the finance industry. Financial firms have funded most of the research, lobbying, and public relations for the campaign to “privatize” Social Security, replacing the current system of guaranteed, publicly-funded pensions with individual investment accounts. The finance industry and its wealthy clients also advocate “consumption taxes”—levying taxes on income spent, but not on income saved—so as to “encourage saving” and “reward thrift.” Not coincidentally, the finance industry specializes in committing accumulated pools of money to the purchase of stocks, bonds and other paper assets, for which it receives generous fees and commissions.

Our entire economic system requires that people spend freely. Yet political rhetoric combined with pressure from the financial services industry urges individuals to save, or at least to try to save. This rhetoric finds a receptive audience in ordinary households anxious over their own finances and among many progressive public-interest groups alarmed by the threadbare balance sheets of so many American households.

So here is the paradox. People need protection against adversity, and an ample savings account provides such protection. But if ordinary households try to save and protect themselves against hard times, the unused factories, barren malls, and empty restaurants would bring those hard times upon them.

SOCIAL WEALTH

The only way to address the paradox is to reconcile individuals’ need for economic security with the public need for a stable economy. The solution therefore lies not in personal thrift or individual wealth, but in social insurance and public wealth.

When a country promotes economic security with dependable public investments and insurance programs, individuals have less need to amass private savings. Social Security, for example, provides the elderly with a direct claim on the nation’s economic output after they retire. This guarantees that retirees keep spending and reduces the incentive for working adults to save. By restraining personal savings, Social Security improves the chances that income earned will translate into income spent, making the overall economy more stable.

Of course, Americans still need to save up for old age;
Social Security benefits replace, on average, only one-third of prior earnings. This argues not for more saving, however, but for more generous Social Security benefits. In Europe, public pensions replace from 50% to 70% of prior earnings.

Programs like Social Security and unemployment insurance align private motivation with the public interest in a high level of economic activity. Moreover, social insurance programs reduce people's exposure to volatile financial markets. Proponents of private asset building seem to overlook the lesson of the late 1990s stock market boom: that the personal wealth of small-scale savers is perilously vulnerable to stock market downswings, price manipulation, and fraud by corporate insiders.

It is commonplace to disparage social insurance programs as "big government" intrusions that burden the public with onerous taxes. But the case for a robust public sector is at least as much an economic as a moral one. Ordinary individuals and households fare better when they are assured some secure political claim on the economy's output, not only because of the payouts they receive as individuals, but because social claims on the economy render the economy itself more stable.

Well-funded public programs, for one thing, create reliable income streams and employment. Universal public schooling, for example, means that a sizable portion of our nation's income is devoted to building, equipping, staffing, and maintaining schools. This spending is less susceptible than private-sector spending to business cycles, price fluctuations, and job losses.

Programs that build social wealth also substantially ameliorate the sting of joblessness and minimize the broader economic fallout of unemployment when downturns do occur. Public schools, colleges, parks, libraries, hospitals, and transportation systems, as well as social insurance programs like unemployment compensation and disability coverage, all ensure that the unemployed continue to consume at least a minimal level of goods and services. Their children can still attend school and visit the playground. If there were no social supports, the unemployed would be forced to withdraw altogether from the economy, dragging wages down and setting off destabilizing depressions.

In a series of articles on the first Bush tax cut in 2001, the New York Times profiled Dr. Robert Cline, an Austin, Texas, surgeon whose $300,000 annual income still left him worried about financing college educations for his six children. Dr. Cline himself attended the University of Texas, at a cost of $250 per semester ($650 for medical school), but figured that "his own children's education will likely cost tens of thousands of dollars each." Dr. Cline supported the 2001 tax cut, the Times reported. Ironically, though, that cut contributed to an environment in which institutions like the University of Texas raise tuitions, restrict enrollments, and drive Dr. Cline and others to attempt to amass enough personal wealth to pay for their children's education.

Unlike Dr. Cline, most people will never accumulate sufficient hoards of wealth to afford expensive high-quality services like education or to indemnify themselves against the myriad risks of old age, poor health, and unemployment. Even when middle-income households do manage to stockpile savings, they have little control over the rate at which their assets can be converted to cash.

Virtually all people—certainly the 93% of U.S. households earning less than $150,000—would fare better collectively than they could individually. Programs that provide direct access to important goods and services—publicly financed education, recreation, health care, and pensions—reduce the inequities that follow inevitably from an entirely individualized economy. The vast majority of people are better off with the high probability of a secure income and guaranteed access to key services such as health care than with the low-probability prospect of becoming rich.

The next time a political candidate recommends some tax-exempt individual asset building scheme, progressively minded people should ask her these questions. If consumers indeed save more and the government thus collects less tax revenue, who will buy the goods these thrifty consumers now forgo? Who will employ the workers who used to manufacture those goods? Who will build the public assets that lower tax revenues render unaffordable? And how exactly does creating millions of little pots of gold substitute for a collective commitment to social welfare?