

# Personal Saving: A Primer for Insurers

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**E**conomists cannot agree on what to do about the 10-year downward trend in the U.S. personal saving rate any more than they can agree on how to measure it.

Is the personal saving rate really that bad, or have we been asking the wrong questions? It appears that, at the very least, we may not have asked as many questions as we should. *How* individual Americans save, now and in the future, rather than *how much* they save, may be just as

Insurers have already benefited from new trends in saving. But demographic studies point to even greater opportunities — and challenges — in the 1990s.

The most widely cited yardstick of the personal saving rate is that of the U.S. Department of Commerce, which aims to measure money available for investment through the use of a "residual" formula. What is left after taxes and consumer spending, Commerce says, is personal saving. According to this method, the personal saving rate has fallen from over 7 percent between 1960 and 1980 to an average of only 4.3 percent in the last three years.

But while most economists agree that the rate derived by Commerce is probably too low, any semblance of accord ends there.

The net national saving rate is made up of individual, or personal saving (what is left of personal income after taxes and consumption); business saving, or profits; and government saving. (Since there is currently a budget deficit instead of a surplus, one might say that government spending is now "in the red." To use an economic term, the federal government is "dissaving." On the whole, state and local governments are doing a better job at saving than is the federal government.)

Simple enough? Not a chance. The problem, some say, is not with the formula, but with its components and the way the personal saving rate is derived. Since Commerce calculates personal saving as a residual, "any error in the estimates of income, taxes and consumer spending will be shown in the saving rate," says Orwin Velz, an

economist at the U.S. Chamber of Commerce. Since the saving rate is already a small figure, relatively insignificant errors can have a disproportionate impact on its calculation. "For example," says Ms. Velz, "if a growing number of people, such as illegal aliens or drug traffickers, receive unreported income but continue to purchase goods and services, it will appear that people consume a higher proportion of their incomes than they really do, resulting in a misleadingly low rate of saving."

And what about home equity? While a small amount of equity is factored into the Commerce equation, appreciation over the rate of inflation is not counted. Given the rise in real estate values during the 1980s, that could be a serious mistake.

Equity in owner-occupied homes reached \$2.18 trillion in 1988. Writing in *The Washington Post* on Nov. 12, 1989, John Berry reported that "Between 1978 and 1988, Americans saved a total of \$1.6 trillion out of their disposable personal income. Over the same period, the average mortgage rose from 36 percent of the value of owner-occupied homes to 40.5 percent, yielding their owners nearly an additional \$600 billion."

Although not immediately available for investment, these and other unrealized savings, such as capital gains on stocks and bonds from the "bull market" of the 1980s, are bound to turn to cash sooner or later. How insurers position their products will determine what percentage of these gains are entrusted to the industry.

These gains, however, may have given consumers cause to decrease other forms of saving that contribute more immediately to the formation of capital. This, in turn, leads some experts to wonder whether we should even be measuring the saving rate — personal or national.

Thomas Swanstrom, chief economist at Sears, Roebuck and Co., supports the theory that, "the real issue is not the flow of saving as represented by the saving rate, but the actual outstanding stock



important as the personal rate of saving, especially to insurers. For the insurance industry, the personal saving rate has an impact on everything from sales of existing lines of insurance to the development of new insurance products.

## Japanese Saving: Myth Or Reality?

**N**ews articles and study papers often allege that Japan has a much higher personal saving rate than the United States.

But Kenichi Ohmae, managing director of McKinsey & Company in Japan, claims that most of the differences between the U.S. and the Japanese saving rate can be negated. Starting with a U.S. saving rate of 4.3 percent, Mr. Ohmae makes adjustments for international calculation standards and accounting inconsistencies that increase the U.S. rate to 10.9 percent. An additional adjustment for "socioeconomic differences" brings the rate up to 14.7 percent, a mere 2 percent less than the Japanese saving rate for the same year.

Said Mr. Ohmae, writing in the *Wall Street Journal*, "Japan's statistics are based on an accounting system advocated by the United Nations. The U.S. figures are based on its own system. The two are significantly different — so much so that one gets a 6.8 percent saving rate for Americans, instead of 4.3 percent, if one

converts the U.S. statistics to the international measure."

Says Orawin Welz, economist at the U.S. Chamber of Commerce, "Those who compare the two rates and argue that the Japanese are more thrifty fail to mention that the U.S. national income account treats public investment as consumption, whereas Japan includes government non-military investment, such as infrastructure, as part of gross saving."

This might not be significant if the Japanese government were not maintaining such a high level of investment — about 8.4 percent of its net national product in the 1970s.

Other important differences, adds Ms. Welz, include Japan's treatment of public pensions as personal saving, while the United States treats them as government saving; its higher home prices and higher down payments for home purchases; higher down payments required for consumer durables in Japan; and, a tax structure in Japan that allows much greater relief from the

double rate of taxation experienced in the United States.

Mr. Ohmae pointed out, for example, that "of the 16.6 percent Japanese saving rate, 7.9 percent goes toward home down payments."

"One can even argue," Mr. Ohmae continued, "that Americans save more than the Japanese. All of the conventional savings statistics are based on 'flow,' or year-to-year savings over discretionary income. However, real savings should be defined as how much you have in 'stock.' The financial assets of the U.S. personal sector in 1985 were \$7.87 trillion. Japan's were \$2.24 trillion. This translates into financial assets of \$33,000 per capita for the U.S. and only \$18,000 for Japan. Americans have more assets in savings, insurance, pensions and securities than the Japanese, who favor our famous tax-free time deposits."

Once again, as Ms. Welz points out, the saving problem and any worthwhile comparisons hinge on the measurement of saving used. ☐

of saving." And, by using this approach, the stark comparisons often drawn between the Japanese and the American saving rates can be knocked down a peg or two.

Just how flawed are the numbers offered by Commerce? No one knows. "Admittedly," says Adren Cooper, economic information officer at Commerce, "our numbers are kind of rough." Ms. Welz, on the other hand, submits two broader measures which, if they do not offer definite answers, at least indicate the breadth of the problem. One measure is calculated from the "saving by individuals" data from the Federal Reserve Board's flow of accounts. Another is achieved by adding to Commerce's rate the

personal and employer contributions for social insurance and employer contributions for private pensions, health and welfare funds.

These figures indicate either a slight decrease or even a modest increase in the personal saving rate.

Confused? Join the club. Laurence Kotlikoff, chairman of the Department of Economics at Boston University, claims all definitions are arbitrary and that there is no real way to accurately break down the aggregate national savings rate into its components. But that aggregate number is no help in tracking personal trends. And those trends are important to insurers. How much Americans can afford

to save, and how much insurance protection they feel is warranted by economic conditions, helps affect the fortunes of the life insurance industry.

Obviously, somewhere between the best and the worst of estimates lies the "real" rate of personal saving. Between it and the Department of Commerce's rate lie uncounted savings, investments and — ACLI statistics show — more private insurance and pensions.

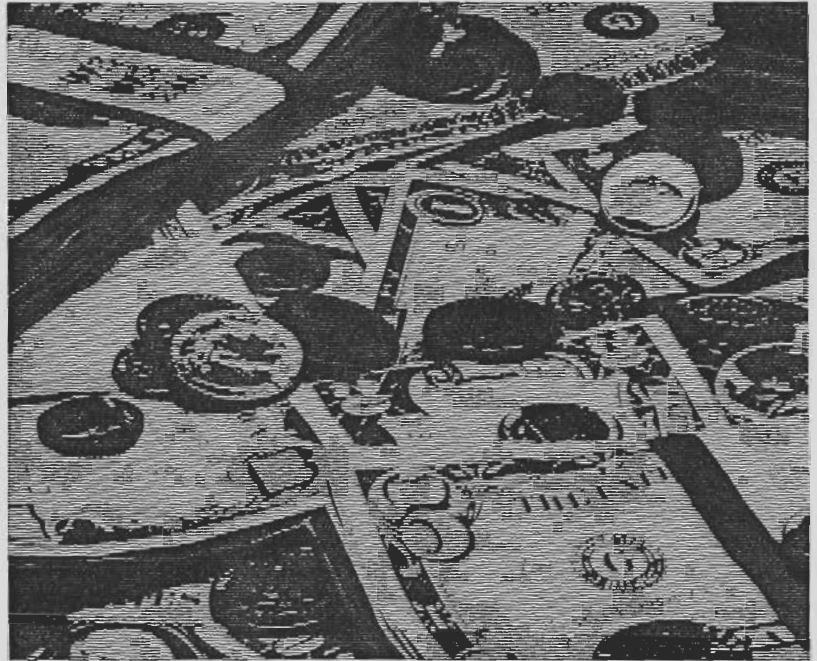
One reason given for the decline in personal saving, however measured, is the expansion of public and private insurance.

Says Mr. Kotlikoff, "The government today provides disability insurance, unemploy-

ment insurance, survivor insurance, earnings insurance (through the progressive tax structure), life span insurance (through social security annuities), old age health insurance, nursing home insurance (through Medicaid) and poverty insurance (through its welfare programs)." These programs, Mr. Kotlikoff asserts, "can have the undesired side effect of greatly reducing national savings." As government programs have expanded, however, private insurance products have experienced tremendous growth. And many of these have a saving component built in that is hard to measure — particularly with the residual formula used by the Department of Commerce.

Life insurance annuity considerations, for example, grew nearly ten-fold between 1978 and 1988, to about \$44 billion. And, assets and reserves of major pension and retirement programs placed with life insurance companies rose from \$119 billion in 1978 to \$569 billion in 1988.

Thus, despite the steady decline in the personal saving rate in the 1980s, life insurance products have flourished.



As retirees begin to focus more on retirement income than on bequests, 75 million baby boomers are entering their forties — the age where, in the past, greater saving has normally taken place. Proponents of the life cycle theory of saving, such as Thomas Swanstrom, say that "people save for their old age. Thus, middle-aged persons envisioning retirement are high savers while the young and the old tend to dissave." Dissave, as noted earlier, means going into debt.

If one believes Sears' Mr. Swanstrom, "in 1993 the saving rate will turn around and then accelerate. By 2010 the saving rate will be challenging the peaks of the early 1970s."

If one accepts that, the question then will be, where will the money go? Historical trends show that Americans maintain or increase protection in economic downturns. In good times, the life insurance industry has an opportunity to attract a greater than ever share of saved funds to the industry.

Although the life cycle theory has some detractors, most economists agree that there will be an increase in the rate of personal saving in the 1990s. While the enthusiasm to save may be dampened by the widespread availability of govern-

ment programs, the different wants and needs of baby boomers may deliver untold opportunities, as well as challenges, to insurers.

Says Robert W. Patin, chairman of the board and chief executive officer of Washington National Corporation, "The baby boom generation is marked by an intense desire to accumulate wealth." Mr. Swanstrom adds, "Annuities are well-positioned to attract some of that wealth. Investment firms are running out of products just as a real pick-up in demand is expected." Mr. Kotlikoff points out additionally that, "baby boomers aren't having as many children, (and are) thereby reducing the need for *short-term* saving." This, of course, spells opportunity for insurance companies that have traditionally sold *long-term* products. Mr. Patin adds that "the apprehensions of baby boomers center around fears concerning loss of life.... Think about the implications."

"For insurers who have traditionally adjusted quickly to changes in economic conditions," says Paul Reardon, the ACLI's director of investment research, "the challenge is to continue developing products suited to the needs of new generations — and now, the baby boomers." ☐

## The deterioration of the traditional American family may be one reason why insurance products have flourished in recent years.

Why insurance products have experienced such growth is still an open question. One answer may be the deterioration of the traditional American family, as evidenced in part by the rising divorce rate. That, says Mr. Kotlikoff, could be one reason for a lessened propensity to save for future generations. With less of a desire to pass on wealth, some economists say, retirees are more likely to want to spend all of their savings before they die — something annuities and pensions, along with government programs, allow one to do with a greater degree of safety than before.