America's Low Saving Rate: What Can We Do?

Mason Gaffney, "Insights" Column in *Groundswell*,

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I. The Prodigal American? On August 2 the Commerce Department announced that "the savings rate" fell to 0.02% - effectively zero - in June. Should we be scared and, if so, what can we do about it? We saw in the last issue that a wealth-elite is pushing Congress to promote "saving" by exempting it from the income tax. That means moving to a national sales tax, or some facsimile. "Saving," however, is one of those catchwords that pols and pundits sling about without having much idea what they mean. Let's have a go at it: what is saving, anyway?

II. Defining saving. Saving is income less consumption. That seems straightforward, but it really isn't, because economists define neither income nor consumption usefully, clearly, or in many cases, at all. Try to find a definition of "consume" and you often find nothing more useful than "Consumption is spending by consumers," or "Consumption is buying consumer goods and services." This term's meaning is now so unclear we will devote the next installment to it. Here, we finesse it temporarily.

How? Saving = income less consumption, and income = consumption plus increase of wealth. Canceling out consumption, we are left with "saving = increase of wealth." That makes intuitive sense, anyway. It leaves many issues, but we will deal with those in the next installment of "Insights."

What is a "useful" definition depends on one's goal. An evident goal of sales-taxers is to make themselves richer, but the public and those to be made poorer demand some sop for the general welfare. The social rationale, the "good reason" used to persuade voters and economists, is to raise domestic capital formation. Let's see how blurred definitions divert us from the goal.

III. Defining "Income".

A. *Taxable income*. The IRS defines taxable income in ways that keep changing with the winds of politics and K-Street pressures on Congress. It is not just details that change, and the evolution is more than incremental. The tax has mutated in a series of basic quantum leaps into a man-eater entirely different from what the voters endorsed in 1913. The "intelligent design" behind this evolution has mostly been the immanent influence of wealth. What we have now takes a lawyer's library to define, but represents no coherent philosophy except the favorable treatment of unearned income at the expense of labor. It was not that way at the outset, when a constitutive alliance of Congressmen including populists, socialists, progressives and single-taxers (one being Henry George, Jr., of Brooklyn) minted the archetypal Revenue Act of 1916 (Brownlee).

B. *Haig-Simons income*. Many, perhaps most tax theorists define the ideal income tax base as "consumption + increase of wealth." "Increase of wealth" results from saving plus capital gains. Capital gains include land gains and stock gains, whether realized by sale or not. This is called “comprehensive income,” and also “Haig-Simons” income, after two early expositors who had been through the single-tax wars of 1890-1925, and understood what their definition implies. So far so good, but there are 3 obstacles that prevent our implementing Haig-Simons:

1. **Eisner v. Macomber, 1920**. Here, the USSC ruled that the Treasury may not tax unrealized capital gains as they accrue (i.e. before sale) until Congress so legislates. Congress never has. Many economists and tax lawyers now write as though the USSC had ruled that to tax unrealized gains is unconstitutional, but that is not what it did. Citing Eisner just lets everyone else off the hook.

Of course it has also let beneficiaries of unrealized gains continue to “grow rich in their sleep” without paying much or any income tax. It has reinforced their expectation that this is their right, that it is good for the country, and enhanced their economic power to hire talent to urge their case. Some of these talents, sheltered in tax-exempt think tanks, even run seminars to “educate” judges about “economics” - their slant on economics.

2. **Aseptic academics**. Some of the academic champions of Haig-Simons keep it just a parlor game for unsoiled hands. They declare it is impracticable to value the increased value of assets, and especially land, every year; so in practice, forget it. William Vickrey and Alan Auerbach have published proposals for applying Haig-Simons, but they involve a lot of bookkeeping, and other economists have turned away from the subject. This manifests a distressing lack of imagination, mathematics, and conviction on their part, for all we need do is what local governments have done with the property tax for nearly 400 years in America: to tax land ad valorem in a rising market (for the mathematics, see Gaffney, 1970). To see that, we need to integrate income-tax with property-tax analysts, who now seem to live in separate gated communities. That goes for some Georgists, too, who simply hiss at all income taxation without trying to understand its possibilities for good, or at least less harm.

3. **Undefined consumption**. A third problem is that to define income by this route we must first define consumption. We have shown above how to finesse that in this paper.

IV. <u>Are land gains income?</u> A big issue remains whether land gains increase national wealth, or just redistribute it in favor of landowners. If the latter, the landowners’ gain is everyone else’s loss, a zero-sum matter.

Henry George in 1879 foresaw and faced this issue:

> “Now, while it is unquestionably true that the increasing pressure of population which compels a resort to inferior points of production ... does raise rents, I do not think that ... it fully accounts for the increase of rent as material progress goes on. There are evidently other causes which conspire to raise rent, ...” (P&P, p.228). “Let us suppose land of diminishing qualities. The best would naturally be settled first, and as population increased production would take in the next lower quality, and so on. But, as the increase of population, by permitting greater economies, adds to the effectiveness of labor, the cause which brought each quality of land successively into cultivation would at the same time increase the amount of wealth that the same quantity of labor could produce from it. *... it would also ... increase the power of producing wealth on all the superior lands already in*

> *cultivation*. ... The aggregate wealth production, as compared with the aggregate expenditure of labor, will be greater, though its distribution will be more unequal." (ibid p.233).

Crude? Perhaps, but later thinkers (notably excepting Alfred Marshall) have added little to that basic understanding, and neo-classical economists have subtracted a lot. George is saying that a large part of land gains actually represent a net gain in national wealth, hence a part of social saving. This gain is a spillover benefit from other lands, from material progress, from education, from improved manners and mores, from public works, etc. - social gains that lodge in private rents. It is an increment to what Alfred Marshall called the "public value of land." Macro-economists have done a disservice by omitting 100% of such gains from their accounts (NIPA). Granted it is hard to distinguish the redistributive part from the "added public value" part, but it is better to be vaguely right than precisely wrong. By omitting land gains entirely, NIPA values both parts at zero, out to as many decimal places as you like. The resulting "precision" is tidy, but understates national saving.

To be sure, today most of this added wealth is privatized. Private landowners treat it as income, and consume much of it. However, NIPA already accounts for that as consumption, and deducts it from saving, as we have seen. What NIPA leaves out is the land gain.

At the other extreme, Michael Mandel of *Business Week*, in an otherwise sharp article (Jan. 17, 2005), counts ALL land gains as net gains to national wealth, because they can be sold to foreigners. That is going too far, as many balked young homeseekers would attest.

V. Gains in stock value. Part of stock gains are gains in aggregate national wealth, too. Consider three major sources of stock gains.

A. *Corporate land*. Corporations are major landowners. Retail chains, forest holders, mineral firms, office owners, mall owners, hotel chains, land developers, fast-food chains and gasoline chains with parking aprons on prime corners, spectrum licensees, and agribusiness giants are a few among many one might list. When the land values rise, the shares rise. There is no danger that NIPA will double count the rises, for it does not count either one.

B. *Mergers and Acquisitions* (M&A). These sometimes benefit corporations by raising actual efficiency; well and good. However, they also benefit some corporations by lowering their numbers and raising their bargaining power: their market power to squeeze suppliers, workers, customers, and host governments. Business reporters often cite such gains to illustrate economies of "scale" and "synergy", but in fact they are at best redistributive. At worst they entail net social losses. The losses are laid out in dozens of older microeconomic texts - but are trivialized in many of the newer ones, that might as well be written by Ayn Rand. Major media and textbook firms are themselves products of M&A, which may color their viewpoint, and certainly enhances their power to overcharge captive-market students for textbooks. At any rate, the part of stock gains that come from enhanced market power are NOT net gains in national wealth.

Some Georgist reviewers of this paper suggested the above paragraph is too critical of M&A. They bypassed the first sentence, and took alarm at the antimonopoly sentiments. This may illustrate how corporate and libertarian propaganda has marinated and turned even many followers of George, a man who dedicated his major book to those who see the vice and misery that spring from unequal distribution of wealth and privilege.

C. *Undistributed profits*. Probably the largest source of stock gains is corporate saving. Corporations routinely squirrel away or "plow back" half or more of their profits to increase their assets. They may acquire new assets; or simply buy back some of their own stock. Either way, it is to convert their shareholders' ordinary income (dividends) into capital gains, to lower the shareholders' taxable personal income. Capital gains are taxed, if taxed at all, at a lower rate; not taxed until sale; and forgiven forever on the death of the personal owner.

NIPA reports two savings rates: "personal" and "national." The "personal" rate is the one near zero, cited in the opening paragraph above. The "national" rate includes corporate saving and government saving. This "national" rate is much higher: corporations do most of our saving. Michael Mandel and Rich Miller, columnists for *Business Week*, deserve credit for pointing this out. However, they get carried away and over-assuage us when they make the saving rate at about 15% of national income as of July 2005. They seem to have taken gross saving for net saving, and credited government with a lot more saving than it really does, if indeed it does any. Federal government saving nowadays is an oxymoron, a bitter joke.

The U.S. Department of Commerce's Bureau of Economic analysis (BEA) reports the undistributed profits of corporations in 2005 so far are running at an annual rate of $521 billions, or about 4.3% of national income. Some unknown fraction of that is not true saving, but a "Capital Consumption Allowance" (CCA) to cover depreciation. BEA reports a small CCA of only $51 billions, making only a dent in the gross figure, but the definitions used are murky, and the numbers therefore worthless. The NIPA scriveners in BEA don't even claim to know how to define depreciation, let alone measure it. Nor can they ever, until they face up to counting Appreciation, for to count Depreciation while blanking out Appreciation is as unbalanced as you can get. We are left with a large measure of doubt about what corporate saving is. We only know it dwarfs personal saving.

VI. <u>Government saving</u>. BEA counts spending on new public works as saving. Fair enough, if you cut out the porkbarrel boondoggling and goldplating and military waste. However, there is no offset for depreciation and obsolescence of existing works. A scary ride on the FDR expressway, built by PWA in the 1930's along the east side of Manhattan, is an object lesson many travelers have survived - so far. Such casual viewing, plus a rash of engineering surveys, tell us that extant roads, bridges, tunnels, dams, aqueducts, sewers, schools, rails, ports, levees (like those that recently failed at New Orleans, and periodically fail in the California Delta) and all the invisible underground networks that tie us together need a lot more repair and maintenance than they have been getting.

Since 2001, Federal deficits have rocketed with numbing regularity. City government treasurers have mastered many arts of concealing liabilities, so debts officially reported are far below real debts, and the surpluses that BEA reports are not to be believed. Harvard Professor Robert Barro assures us that private saving will rise to compensate for government debt, and standard modern economics texts, ever behind the facts, still would have students take this seriously. What we see, though, is private (non-corporate) saving falling to zero while federal dissaving soars into orbit.

VII. Balance of Payments. Lacking well-conceived data categories from BEA, the best indicator of our saving shortfall is the balance of payments. Here there is no doubt. We borrow hugely abroad each year, which automatically makes us import more than we export as we hock or sell parts of the nation to foreigners, and reconvert our nation into the economic colony it was before 1914: shirtsleeves to shirtsleeves in three generations.

Is that bad? Some say it just shows that America is the best place to invest, thanks to our low taxes and pro-business climate. That is too sanguine. If foreign money were making American jobs and raising wages, wonderful; but when it is used to buy American securities and real estate and U.S. bonds, while American jobs are outsourced offshore, I think we'd better think it out again.

Should we worry? Yes, about several things. First is the perpetually rising fraction of corporate wealth in total wealth that must result in the future from high corporate saving relative to low personal saving. Second is the nation's growing dependence on foreign loans, and vulnerability to a run on the dollar with soaring interest rates. Ben Bernanke, once an insightful observer, assures us we can depend indefinitely on a global glut of savings, but now he is in politics I am not soothed. Third is the tendency of most of the media and the texts, dominated by corporations, to misdirect public concern away from the growing concentration of wealth and power. Fourth is the growing diversion of new savings, both corporate and foreign, from making new jobs in America to amassing old assets like land, and mortgages on the same when the borrowers are just withdrawing equity for consumption, and government bonds.

VIII. Does saving alone create capital? We know we must save the seed corn, that is basic and proverbial. However, capital formation depends on investing as much as, maybe more than, on saving. Corporations that sock away profits, or spend them to acquire and retire competitors and downsize their workers are not adding to national income, production, or wealth. Foreigners who buy U.S. mortgages, real estate, bonds, and extant securities are not, either.

What we need is a high rate of return (ROR) on real net investing. That means productive, active, income-creating investing, actually paying workers to produce new capital (or other goods and services), as opposed to just buying land, or swallowing competitors. Except, make that Marginal Rate of Return (MROR), for that is what makes people invest to make jobs. The excess of Average Rate of Return (AROR) over MROR is mostly land rent. Buying land and paying rent do not make jobs. Again, finally, make that Marginal Rate of Return After Taxes (MRORAT), for the after-tax return is what moves investors.

That is what both Henry George and John Maynard Keynes were all about. Keynes called it the "Marginal Efficiency of Capital" (MEC). Keynes, and later his followers in the age of JFK, pursued a variety of measures to raise the MRORAT, or MEC. Some of the measures were too gimmicky, perhaps, but the basic idea was always there: raise investing of the net income-creating kind. After 1980, however, economists gradually slid away from distinguishing active, Keynesian net investing from just piling up assets as passive stores of value. Keynes' distinctive term, the MEC, is nearly extinct today. Losing the terminology is no disaster per se, "efficiency" was never the right word. However, MEC does contain the key word, "Marginal." Macroeconomists and policy-makers are losing the concept behind it, the difference of MARGINAL rates of return, net of rent, and AVERAGE rates, including rent. So-called "supply-side economics" has come to include mainly measures to untax and raise rents and land values and unearned increments. Real wage rates have been falling ever since.

George was more direct and thoroughgoing: untax wages, untax capital, tax land values. It is a macro-economists dream: raise active investing, make jobs, raise saving, provide for government spending, all in one stroke. It is hard to explain, without being impolitic, why macroeconomists hold back from touting George's program.

IX. How to raise domestic savings. There was a simple old formula saying that savers respond to higher interest rates. That has been scoffed away, but it is true. The scoffers simply missed the intermediate step that high interest rates lower values of old property, and that is what makes people save: the need to replenish assets.

There is a diminishing marginal need for private assets. Any private asset that is not real capital is a portfolio substitute for real capital, and has the effect of satisfying the need for wealth without any real capital formation. The formula for raising domestic savings rates is to deflate values of these substitutes. Emancipating slaves once had such an effect. Today, the major portfolio substitutes for real capital are land values and government bonds. To lower land values, untax capital to raise the MRORAT, which raises the cap rate. Also, tax the land values, for the property tax rate is also part of the cap rate. To shrink the supply of government bonds, pay as you go - by taxing land values. The basics are really pretty simple.

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