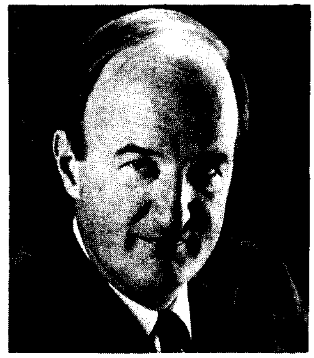
IDEAS ON LIBERTY
MARCH 2000



Will the Savings Crisis Lead to Stagnation?

"There is a virtuous cycle in which high growth promotes high saving, and high saving in turn promotes high growth."
—JOSEPH STIGLITZ, Chief Economist, The World Bank

"America's Expansion Cannot Be Sustained."
—*The Economist*, November 6, 1999

In a return to the principles of classical economics, more and more economists agree that thrift is a virtue and should be encouraged. In the textbooks, Harvard's Greg Mankiw promotes the new view toward saving: "Higher saving leads to faster growth."[1] Contrast Mankiw with the anti-saving mentality held by Paul Samuelson and other old Keynesians, who argued that higher saving may result in a recession or worse ("the paradox of thrift").

A newly released study by the World Bank reinforces this new positive outlook for saving.[2] Under the guidance of chief economist Joseph Stiglitz, the bank came to the following startling conclusions regarding world saving:

Saving and interest rates: "The world saving rate has been declining and the world real interest rate has been increasing since the 1970s" (p. 7). Of course, saving rates vary dramatically among countries. For example, they have doubled in East Asia, stagnated in Latin America, and collapsed in sub-Saharan Africa.

Saving and income: "Long-term saving rates and income levels are positively correlated across countries" (p. 12). In other words, saving rates tend to rise with per-capita income. As people become wealthier they tend to save more. But only up to a point. The World Bank notes that saving ratios appear to level off at high levels of income.

Saving and economic growth: "Higher-saving regions have also enjoyed faster income growth." Countries that save more also grow more, although the evidence is not clear which comes first, faster growth or higher saving. In any case, they go hand in hand. Stiglitz concludes, "high saving is associated with good macroeconomic performance and sustainable access to foreign lending" (p. ix).

Saving and foreign aid: "Most [economists] conclude that aid crowds out national saving" (pp. 17–18). Given that the World Bank's purpose is to dole out foreign aid, this frank admission is amazing.

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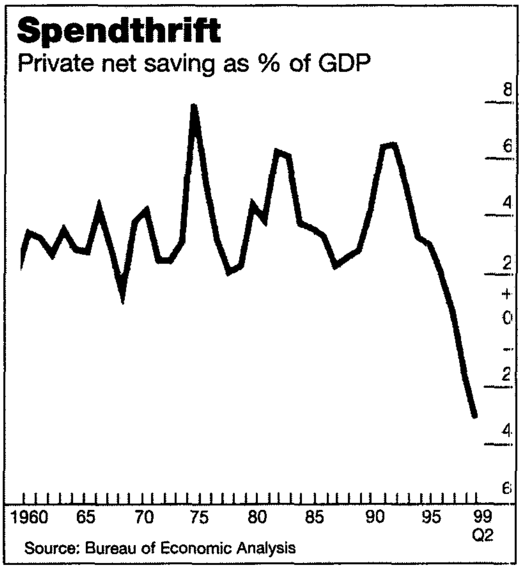
U.S. Living on Borrowed Time

Given this positive relationship between saving and economic performance, what are we to make of the sharp decline in private net saving in the United States? The latest data indicates that private net saving—the gap between disposable income and spending—has fallen to a record low of negative 5.5 percent of GDP in 1999. (See the graph below.)



Of course, millions of Americans continue to save for retirement, investment, and other reasons, but lately the debtors have outnumbered the savers. The tenuous government surplus has only partly offset the private-sector dissaving. Who makes up for the imbalance? Foreign investors (as reflected in the growing current-account deficit) are pouring billions into U. S. debt and equity securities, bank accounts, and real estate.

A recent study by two British economists, Wynne Godley and Bill Martin, warns that the United States is headed for serious trouble. They point to three unsustainable imbalances: an overvalued stock market, the collapse in private saving, and an alarming increase in debt.[3]

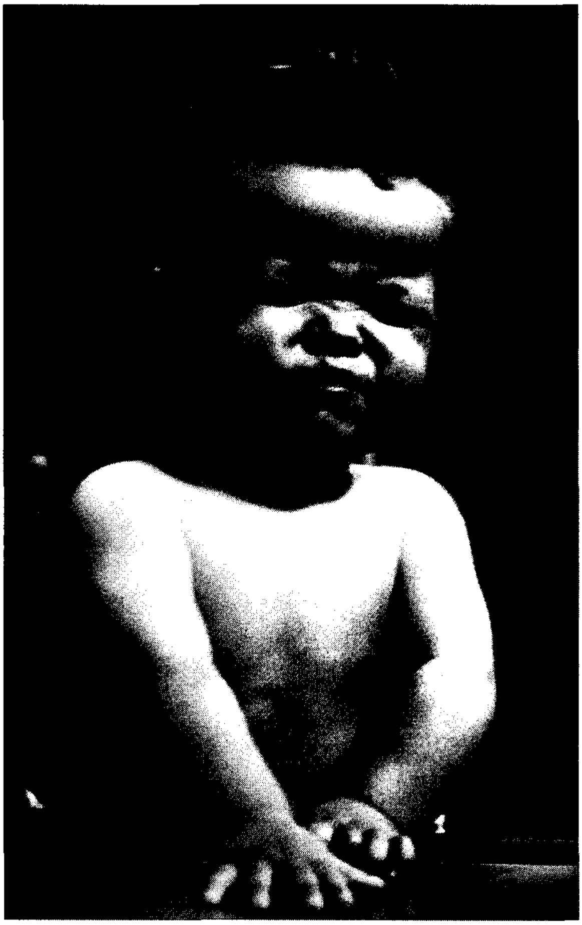
Other countries facing these imbalances—Japan, Britain, and Sweden in the late 1980s—experienced sharp slumps after asset-price bubbles burst.

What has caused the sharp drop in U.S. private net saving? Many economists blame the booming stock market, encouraging households to spend more and firms to invest more. I would add two other factors: the Bush-Clinton increases in the marginal tax rate (higher tax rates reduced disposable income, forcing households to save less) and the Federal Reserve's liberal monetary policy since the 1997 Asian financial crisis (monetary inflation has fueled the bull market on Wall Street).

Throughout the 1980s and 1990s I was bullish on the U.S. stock market. Supply-side economics and globalization kept inflation under control and the economy out of recession. Now, as we enter a new century, most trends are still positive, but we must not ignore the signs of inflation. If Ludwig von Mises and F. A. Hayek taught us anything, it is that artificial prosperity fueled by debt and monetary inflation cannot last forever. The bust is inevitable, although its severity can be offset by tax cuts, privatization of Social Security and Medicare, and expanded savings. □

1. N. Greg Mankiw, *Macroeconomics*, 2nd ed. (New York: Worth Publishers, 1994), p. 86.
2. All citations are taken from Klaus Schmidt-Hebbel and Luis Servén, eds., *The Economics of Saving and Growth* (New York: Cambridge University Press, 1999).
3. "Living on Borrowed Time," *The Economist*, November 6, 1999.

Have you heard the latest from Washington?



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CAPITAL LETTERS

Why Y2K?

To the Editor:

"Bill O. Reitz" overcomplicates the Y2K situation ("Why Y2K?," December 1999). I spent over 20 years in the information-processing business from the late '60s until the early '90s, so I have some knowledge of the genesis and continuation of the so-called Y2K problem. I worked with "magnetic drum" and "core" as well as punched cards, sorting and collating machines, and all the other paraphernalia of the early days. I have no real problem with either of Mr. Reitz's descriptions of how two digits were used to save space. I can remember programming subroutines in "machine language" to save a few bits (not bytes) of precious room. So I'm just as guilty as anyone, if indeed guilt is the appropriate term.

I start to lose patience when people say that Y2K came as a surprise to the industry and that programmers and analysts are at fault for not correcting the problem before it became critical. When I first went to computer school in the '60s it was made clear that the two-digit date was a matter of expediency and would cause problems sooner or later without attention. Anyone in data processing who had a two-digit IQ knew it was a time bomb.

As far back as the late '70s and early '80s I recall sitting in design and development meetings where the technical people strongly urged that the date fields be expanded because it was becoming apparent that software had a much longer life span than had been thought. In every case it was the managers/bureaucrats/executives at the urging of the "bean counters" who decided that such a change was a budget- and schedule-buster, and they weren't about to spend the resources. So in fact Y2K came to be in spite of technical protests, and programmers and/or analysts are not to blame.

It's also my opinion that the job mobility of people in data processing at the time contributed to the problem because the responsible (or irresponsible) managers/bureaucrats/executives could be fairly certain that they would no longer be employed at the same place when the "%&#@ hit the fan" (euphemism for Y2K).

The upshot is that the Y2K problem is the result of bad business decisions, not technical "stupidity and incompetence."

—Charles Stone
Kissimmee, Florida

Bill O. Reitz replies:

The point of my article was why Y2K came to be in the first place, more than why it was perpetuated. As for overcomplication, as I said, I don't know if such an analysis (as I included in the article) was done or not; but that if one was done, the programmers (and managers) made what they would have concluded to be the correct decision based on the available information.

I don't think that Y2K was a surprise to anyone in the know. Even the original programmers no doubt knew of the problem and that someday things would need to be done differently. Mr. Stone implies an interesting point, which I had not considered—that the reason the Y2K "bug" was perpetuated was that software was written incrementally, that is, each new version was derived by modifying the previous version. Given this approach, it is easier to understand why the managers might have acted as Mr. Stone says. This would support Mark Skousen's idea, which is that people who should have known better took a short-sighted approach for short-term gain. Even then, though, it is possible that the managers simply chose to defer this expense to the future. Unless there is a particular advantage to fixing a problem right away, it