

(39) Juster, F. Thomas; Lupton, Joseph; Smith, James P.; and Frank Stafford. "The Decline in Household Saving and Wealth Effect." Mimeo, 2001.

The authors argue that the decline in the private household savings rate was a direct consequence of the large capital gains households received during the stock market boom of the 1980s and 1990s, considering the interrelationship between capital appreciation in alternative types of households assets and desired household savings.

The empirical objective is to estimate the behavioral response of total active saving to total capital gains. The household active saving is the change in wealth between two dates, adjusted for any capital gains or losses and any net transfers into the household. The specification estimates the effect of within household changes in capital gains on within household changes in active savings, where the model includes other variables controlling for age, changes in family composition resulting from marital transitions, the between wave amount of inheritances received and the amount of all net transfers into the household, for the PSID waves of 1984, 1989, and 1994.

When all sources of capital gains are combined into a single aggregate, the results indicate an effect of 2.7 cents per dollar, which is consistent with prior estimates of aggregate estimates of the wealth effect. When the authors separate capital gains into those associated with housing, stock and others, the estimates show that a dollar of capital gains in stocks reduces active saving by about 17 cents, while a dollar of capital gains in housing reduces saving by roughly 3 cents and is not statistically significant, while the impact of capital gains in other tangible assets is essentially zero. To deal with the mechanical bias introduced by the negatively correlated measurement error in active savings and capital gains, the authors redefine active savings to exclude active savings in stocks, and they find that the estimates of capital gains in stocks effect have been trivially reduced to 16.6 cents reduction on saving, showing that the bias is small. Adding a variable interacting capital gains in the stock market with the existence of a private pension for at least one spouse, they find that the impact of capital gains in stocks is statistically significant for both those with and without pensions, but is more than twice as large for those respondents with a pension (20 cents compared to 10 cents only).

Separating active saving into financial and nonfinancial savings, they find that the wealth effect from appreciation in corporate equity appears to be divided roughly equally between financial and nonfinancial saving. To address the question of whether their estimated effects of capital gains can account for the decline in US saving rates, they use their estimates to predict observed saving rates allowing for year by year changes in mean household income and capital gains in stock and housing, and find that their model predicts a decline in saving rates very close to the observed, but it does less well on the exact timing of change, under predicting the fall between 1984-1994 and over predicting the subsequent rise between 1994-1998.

