IMPACT OF ALL SAVERS CERTIFICATES ON SAVINGS

Report of the Secretary of the Treasury
to the United States Congress
Pursuant to Section 301(c)
Public Law 97-34
Economic Recovery Tax Act of 1981

U.S. Department of the Treasury
Washington, D.C.
May 1984

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

MAY 17 1984

Dear Mr. President:

Section 301 of the Economic Recovery Tax Act of 1981 provides that "The Secretary of the Treasury or his delegate shall conduct a study of the exemption from income of interest earned on depository institution tax-exempt savings certificates established by this section to determine the exemption's effectiveness in generating additional savings."

Pursuant to that section, I hereby submit a study on "The Impact of All-Savers Certificates on Savings."

I am sending a similar letter to Thomas P. O'Neill, Speaker of the House.

Sincerely,

John E. Chapoton
Assistant Secretary
(Tax Policy)

The Honorable
George Bush
President of the Senate
Washington, DC 20510

Enclosure

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WASHINGTON, D.C. 20220

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I am sending a similar letter to the Speaker of the House and to the Chairman of the Committee on Finance.

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John E. Chapoton
Assistant Secretary
(Tax Policy)

The Honorable
Dan Rostenkowski, Chairman
Committee on Ways and Means
House of Representatives
Washington, D.C. 20515

Enclosure

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John E. Chapoton
Assistant Secretary
(Tax Policy)

The Honorable
Robert Dole
Chairman, Committee On Finance
United States Senate
Washington, D.C. 20510

Enclosure

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Speaker of the House
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Enclosure

Impact of All Savers Certificates on Savings

Background

The Economic Recovery Tax Act of 1981 included several savings provisions, among them the creation of All Savers Certificates. These certificates were to be offered by depository institutions: banks, savings and loan associations, and credit unions. The act limited the issuing authority to 15 months, from October 1, 1981 to December 31, 1982, and limited the tax exclusion to a cumulative total of $1,000 of interest earned on such certificates ($2,000 for a joint return). The interest paid on these certificates was declared tax exempt, and the yield was specified by law as equal to 70% of the average investment yield on United States Treasury bills with maturities of 52 weeks. This tax exempt yield would change with each new auction of Treasury bills. The certificates were to be made available in denominations of $500 and any other denomination at the discretion of the depository institution.

Although the declared purpose of All Savers Certificates was to generate additional saving, the real purpose was generally conceded to be to reduce the cost of funds to depository institutions, particularly thrift institutions. Thus, the key provision, in addition to tax exemption, was the ceiling on the interest rate which could be paid. Without the ceiling, competition among issuers would have driven interest rates paid by eligible institutions to approximately the same level as paid on other financial instruments. This would have increased the after-tax return to depositors, as compared to taxable instruments, and increased the incentives to save, but it would have provided no reduction in the cost of funds for thrifts. Congress, by enacting the ceiling, enabled thrifts to obtain funds more cheaply than they would have been able to otherwise.

The tax exempt nature of the All Savers Certificates interest combined with its one year maturity made it attractive to individuals and households who had marginal tax rates above 30% and who desired a short-term investment with great safety of principal. The penalty for early withdrawal (full inclusion of present and past interest in taxable income) made them somewhat illiquid.

The Issue of All Savers Certificates

In examining the impact of All-Savers Certificates on savings, it is worth asking 3 different questions: Who issued them? Who bought them? and Where did the funds come from?

Tables 1 and 2 provide monthly statistics on the dollar value of All Savers Certificates, both as new issues and as the total stock outstanding. It appears that total issues during the life of the program amounted to around $55 billion.1/ More than half of all of the ASCs issued went out in the first month of the program, October 1981, and about 80 percent of all ASCs were issued in the first three months. Although the program was initially tailored to benefit savings and loan institutions, after the first month of the program more ASCs were issued each month by commercial banks than by the savings and loans. After December of 1981, commercial banks had the most ASCs' outstanding, followed by savings and loans; mutual savings banks

1/ Because the statistics are available only on a "net" basis, we cannot be certain of the precise figure. For example, while the "net" new issues in October 1982 were a negative $26 billion, this represented the cashing in of year-old certificates which was offset, but only in part, by the issuing of new ones.

Table 1

All Savers Certificates
(New Issues Net of Retirements)
($millions)

	Savings and Loans	Commercial Banks	Mutual Savings Banks	Total 1/
October 1981	$14,980	$12,807	$ 2,299	$31,086
November	2,660	4,139	849	7,648
December	716	1,658	337	2,711
January 1982	854	1,018	309	2,221
February	570	722	197	1,489
March	810	991	263	2,064
April	580	692	186	1,458
May	370	517	133	1,020
June	330	247	189	766
July	380	428	30	838
August	320	363	119	802
September	246	398	142	786
October	-12,876	-10,415	-2,882	-26,173
November	- 2,890	- 3,519	- 762	- 7,171
December	- 460	- 1,413	- 281	- 2,154
January 1983	- 920	- 1,673est	- 178est	- 2,771
February	- 590	- 500est	- 150est	- 1,240
March	- 700	- 500est	- 100est	- 1,300

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January 23, 1984

1/ Excludes All Savers Certificates issued by Credit Unions.
Source: Federal Home Loan Bank Board and Federal Reserve Board.

Table 2

All Savers Certificates
(Outstanding)
($millions)

	Savings and Loan	Commercial Banks	Mutual Savings Banks	Total
October 1981	$14,980	$12,807	$ 3,299	$31,086
November	17,640	16,946	4,148	38,734
December	18,356	18,604	4,485	43,745 1/
January 1982	19,210	19,662	4,794	43,666
February	19,780	20,384	4,991	45,155
March	20,590	21,375	5,254	47,219
April	21,170	22,067	5,440	48,677
May	21,540	22,584	5,573	49,697
June	21,870	22,831	5,762	53,363 1/
July	22,250	23,259	5,792	51,301
August	22,570	23,622	5,911	52,103
September	22,816	24,020	6,053	52,889
October	9,940	13,605	3,171	26,716
November	7,050	10,086	2,409	19,545
December	6,590	8,673	2,128	18,591 1/
January 1983	5,670	7,000est	1,950est	14,620
February	5,080	6,500est	1,800est	13,380
March	4,380	6,000est	1,700est	12,080

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Office of Tax Analysis

1/ Includes, for December and June only, All Savers Certificates issued by Credit Unions.

Source: Federal Home Loan Bank Board, Federal Reserve Board, and Federal Financial Institutions Examination Council.

and credit unions lagged far behind. Because they are so much smaller in the aggregate than commercial banks, savings and loans actually had ASC's making up a larger percentage of their deposits than banks did.

Who Purchased All-Savers Certificates?

The only information available on the purchasers of ASCs comes from individual tax returns. Taxpayers receiving interest from ASCs were required to indicate the amount on line 1c of Schedule B attached to their Form 1040. The instructions specified that this line was to be filled out even if the amount received was less than $400, the normal "reporting threshold" for interest received. In Calendar Year 1981, about 6,000 individual tax returns reported ASC interest. The low response was presumably the result of the policy of many financial institutions to credit the interest only when the certificate matured, i.e., in 1982.

Preliminary statistics for Calendar Year 1982 representing 95 1/2 million returns filed for that year are shown in Tables 3 and 4. Slightly over $4 billion in interest was reported on 4 million returns, representing an average of just over $1,000 per return. This last figure must be interpreted with care, however, for it represents an average over both single returns which had a ceiling of $1,000 and joint returns, which had a ceiling of $2,000.

Looking at the breakdown by AGI (Adjusted Gross Income), we see that ASC interest was quite unusual for incomes under $50,000. This is hardly surprising, because at those income levels, tax rates are low enough that ASCs were probably not a sensible investment. For higher income brackets, roughly a quarter of the returns reported ASC interest. All in all, 4% of all returns reported some ASC interest.

Table 3

All-Savers Interest Reported on Tax Returns
(Preliminary Statistics)

AGI	Number of Returns	Share of All Returns	Average Amount
(Thousands)	(Thousands)	(Percent)	(Dollars)
Under 10	307	0.9%	$ 708
10 - 15	272	1.9	828
15 - 30	1,094	4.0	939
30 - 50	1,412	9.9	1,124
50 - 100	804	21.0	1,326
100 - 200	152	26.9	1,540
200 - 500	39	28.0	1,645
500 - 1 million	5	25.9	1,677
Over 1 million	2	22.7	1,696
All	4,087	4.3%	$1,085

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January 23, 1984

Looking at Table 4 we can see how reported ASC interest was distributed across income classes. Also shown is the distribution of income (adjusted gross income) and tax liability (tax after credit). The major share of ASC interest was reported by taxpayers with AGI between $15,000 and $50,000. As the second column in the table shows, this is where most of the income is, as well. Comparing the two columns, we see that taxpayers with income between $30,000 and $200,000 had a larger share of ASC interest than they did of income. For both lower income taxpayers (under $30,000) and higher income taxpayers (over $200,000), the share of ASC interest was smaller than the share of AGI.

Comparing the distribution of ASC interest and tax liability, we get a somewhat different picture. Taxpayers with incomes below $100,000 had a larger share of ASC interest than they did of tax liability. Conversely, taxpayers with income over $100,000 accounted for more tax liability than they did ASC interest.

Because the amount of ASC interest that was tax-deductible had a ceiling, we can infer from statistics on amount issued and interest rates just what the minimum number of investors must have been. For example, in the first month of issue, October 1981, $31.086 billion of ASCs were purchased. The yield for the first week was 12.61%, while for the remainder of the month it was 12.14%. Thus, during the first week, it would have taken an investment of $7,930 (= $1,000/.1261) to earn the maximum amount of tax exempt interest.

If we assume that three-quarters of the first month's issues were purchased at the opening, and the remaining during the rest of the month, then a minimum of 3.9 million purchasers1/ must

1/ Note that a "purchaser" may be either an individual or "half" of a joint return in which each person purchases the limit.

Table 4

Distribution of All-Savers Interest Reported on Tax Returns
(Preliminary Statistics)

AGI (thousands)	ASC Interest (Share of All Returns)	Adjusted Gross Income (Share of All Returns)	Tax Liability (Share of All Returns)
Under 10	4.9%	7.9%	0.8%
10 - 15	5.1	9.4	2.8
15 - 30	23.2	32.4	22.1
30 - 50	35.7	29.2	33.1
50 - 100	24.0	13.2	21.2
100 - 200	5.3	4.0	9.0
200 - 500	1.5	2.2	5.8
500 - 1 million	.2	.7	2.1
Over 1 million	.1	1.0	3.1
All	100.0	100.0	100.0

Office of the Secretary of the Treasury   February 16, 1984
Office of Tax Analysis

have acquired ASC's during that month. Analagous calculations, employing statistics on ASCs issued and prevailing interest rates, indicate that at least 6.3 million people must have invested in ASC's during the life of the program. Note that this assumes everyone invested up to the maximum; to the extent that some investors purchased less than the maximum, more investors must have acquired ASCs. Thus our 6.3 million estimate of investors is a minimum.

Did These Dollars Represent "New" Savings?

In summary, a large number of investors purchased ASCs, and they devoted some $55 billion to this purpose. Do these figures mean that the ASC program was successful in its stated purpose of stimulating additional savings or did it merely direct savings from other assets? This sort of question is always extremely difficult to answer on the basis of historical statistics. The difficulty is that we do not have a "controlled experiment" and therefore cannot be certain what "would have happened if". For example, if savings had increased when ASCs were introduced that could not be taken as proof that ASCs caused the increase--it is always possible that savings would have increased even more in their absence. Conversely, a decline in savings at the time ASCs were introduced would not disprove the effectiveness of ASCs in stimulating savings--in the absences of ASCs savings might have declined even more. Thus, economic analysis can at best provide us with only indirect evidence. However, certain time series can serve to place ASCs in perspective and indicate the likely magnitude of their impact.

Table 5 shows savings by the "household sector" in different forms for the period 1978 first quarter through 1982 fourth quarter.2/ The first column shows the estimated change in ASC's

2/ In the Flow of Funds accounts, households, personal trusts, and nonprofit organizations are combined.

Table 5

Household Sector Savings Flows
(Seasonally Adjusted at Annual Rates)
(Billions of Dollars)

	All Savers Certificates(est)	Small Time and Savings Deposits	Large Time Deposits	Money Market Fund Shares	Net Saving Flow of Funds	Total Personal Saving (National Income Accounts)
1978 - 1		64.1	33.3	6.9	166.3	94.3
2		66.8	47.5	5.4	174.5	83.6
3		78.1	33.2	5.8	177.2	89.5
4		46.6	31.7	9.6	180.7	90.0
1979 - 1		74.3	8.6	28.8	174.2	98.0
2		69.0	-2.3	31.6	184.9	102.8
3		64.5	45.4	33.1	177.8	98.6
4		38.6	15.9	44.1	161.2	87.3
1980 - 1		51.8	40.5	61.2	183.8	100.8
2		100.1	-18.7	62.5	178.3	113.2
3		99.1	24.9	5.1	176.1	112.2
4		82.5	122.0	-11.9	181.9	114.6
1981 - 1		28.2	-7.3	148.4	189.6	112.2
2		31.7	60.8	59.9	206.3	120.2
3		58.1	30.8	137.3	245.5	149.7
4*	43.7	70.3	-7.6	84.3	233.4	159.0
1982 - 1	5.8	102.1	11.2	38.2	215.4	130.8
2	6.1	86.8	11.1	40.5	214.2	127.1
3	2.4	127.6	-40.6	88.1	200.5	123.0
4	-34.3	225.2	-41.9	-68.1	210.8	120.8

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First quarter for All Savers Certificates

ource: Federal Reserve Board, Flow of Funds outstanding. As noted above, the program started with a bang in the fourth quarter of 1981, but rapidly diminished thereafter. The 2nd column gives the quantity of "small time and savings deposits" by quarter. (This is the category in which All Savers Certificates are included in the Flow of Funds Accounts.) This fluctuates fairly widely, from a low of $28 billion in the first quarter of 1981 to a high of $249 billion in the fourth quarter of 1982. The biggest single quarter for issuing ASCs was the fourth quarter of 1981 when $43.7 billion were issued. It can be seen that there was an increase in small time and savings accounts that quarter. However, that increase was smaller than the one that had occurred between the 2nd and 3rd quarters. Furthermore, there was an even larger increase in small time deposits between the fourth and first quarters, when new ASC issues dropped from $43.7 billion to under $6 billion.

There also was a sharp drop-off in <u>large</u> time deposit savings between the 3rd and 4th quarters of 1981, from plus $31 billion to minus $8 billion.

The fourth column of Table 5 shows another investment series which casts doubt on the net impact of ASCs. Money market funds had been growing at an extremely rapid rate during 1981, but this rate of growth slackened dramatically in the 4th quarter, dropping from net investment of $137 billion to $84 billion, although even this latter figure was almost twice the investment of ASCs. This decline in growth of some $53 billion undoubtedly provided some of the $44 billion which went into ASCs.

Thus, ASCs do not seem to have played a large role in household financial investment in 1981 fourth quarter, and there is no evidence that they represented any net increase in such saving then.

The fifth column in Table 5 shows total net savings flows for the household and nonprofit sector in the Flow of Funds Accounts. We can see that this measure of saving actually peaked out in the third quarter of 1981 and started declining in the fourth, just as ASCs were introduced. Finally, the last column shows personal saving on a National Income Accounts definition. This differs from the Flow of Funds definition in two respects: 1) claims by individuals against insurance and pension trust funds of governments (both Federal, State and local) are considered savings in Flow of Funds and not in National Income Accounts. 2) net expenditures on durable goods are considered to be consumption in the National Income Accounts, but savings in the Flow of Fund accounts. This somewhat more restricted concept of savings does show a rise in the fourth quarter of 1981, although the rise was smaller than had occurred in the third quarter. While ASCs may have played a part in this savings increase, two other factors also came into play in that quarter. The Economic Recovery Tax Act (ERTA) became effective at the beginning of the fourth quarter, causing personal tax payments in the national income accounts to decline from the third to the fourth quarter. In addition, there was a severe slump in automobile sales during that quarter, and because of the different way durable purchases are handled in the Accounts, this decline in auto sales is reflected as <u>higher</u> savings in the last column of Table 5 (NIA) but was a major factor in the <u>decline</u> in savings in the next to last column (Flow of Funds Basis).

Can these statistics tell us where the money for All Savers Certificates came from? We cannot be certain, of course, because there were many other factors operating, but Table 5 certainly provides no evidence of any increase in personal savings which might be attributed to ASCs. The increase in small time and savings deposits in 1981 fourth quarter was more than offset by both the decline in large time deposits and the decline in new investment in money market fund shares.

Finally, we might note that the period of liquidation of ASCs, the fourth quarter of 1982, coincides with the largest increase in small time and savings deposits in years.

Table 5 shows the large magnitudes involved in private financial assets. However popular All Savers Certificates may have been with those who purchased them, they accounted for only a tiny fraction of aggregate household savings and did not even cause a ripple in aggregate time series.