The bias against saving

By Buttonwood
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It seems hard these days to find anyone who has a good word for savings, or savers. There has been talk of a global “savings glut” for a decade now, and Ben Bernanke, one of the original proponents, still sees the concept as a “useful perspective” for understanding current economic conditions. Part of the idea of near-zero interest rates in the developed world is to discourage saving and to encourage borrowing. The perceived problem is that money saved is not money spent and thus the effect of saving is to reduce aggregate demand; by keeping a dollar in your pocket, you deprive a neighbour of employment. This is the “paradox of thrift”; if everyone tries to save too much, the economy will contract and the average person will be poorer, not richer.

This argument is extended to governments pursuing austerity policies, aiming to borrow less (or aim for an eventual surplus). To the extent that governments tax more on spend less, that will subtract demand from the economy; individuals and companies will have less money to spend. Again, the effect may be to slow the economy, causing tax receipts to be lower (and social benefits higher) than the government expects; the deficit may thus fall more slowly than expected (or even rise). This might be called the “paradox of austerity”.

At the national level, there are attacks on current account surplus countries like Germany, especially when they lecture deficit countries like Greece. Here again, the perceived problem is one of fallacy of composition. All countries cannot run surpluses. The Greek deficit is thus the counterpart of the German surplus. And a country with a surplus ends up with a claim on debtor countries in the form of government bonds, bank loans etc. If one country is in quasi-permanent surplus, and the other in deficit, these bonds and loans can never be repaid; is this the fault of the irresponsible debtor or is it the creditor (saver) that is being irresponsible? Surplus countries are dubbed “mercantilist”, after the old notion that the purpose of trade should be to accumulate reserves (gold under the old system); a notion swept away by the idea that the object should be to increase the overall volume of trade, making everyone better off.

And yet. We know that savings equal investment and investment is need to grow an economy over the long term. We also know that individuals need to accumulate savings pots to see them through retirement — governments offer tax breaks to pension savings to encourage this process. And one could also argue that developed countries with ageing populations should be running current account surpluses, and emerging economies should be running deficits; capital should be flowing from slow-growing countries to faster-growing places.

It is very easy to get confused by all this and there was a spectacular example by David Graeber in the Guardian this week. He uses the concept of the flow of funds within the economy; if the public sector runs a surplus, the private sector must run a deficit and vice versa (he doesn’t really deal with the overseas sector). At one point, he runs a chart of the British fiscal balance and GDP growth and writes that

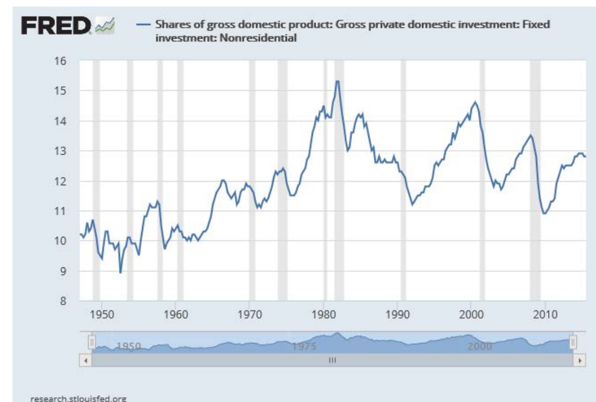
> “There were three times in recent decades when the government ran a surplus. Note how each surplus is followed, within a certain number of years, by an equal and opposite recession.”

One of his examples is the late 1990s surplus which "after a certain number of years" was followed by the 2008 recession! How did the former cause the latter? Indeed, how did the late 1960s surplus, accumulated by then-chancellor Roy Jenkins lead to the 1973-74 slump? Might the oil crisis (or the credit boom of the Heath years) not have played a bigger part?

Causality is the main issue. In a boom, tax receipts rise and spending on unemployment benefits falls; governments tend towards a surplus. In a slump, the opposite occurs. Although governments tend to tinker round the edges with fiscal policy, these effects are usually dwarfed by the impact of macroeconomics. The $800 billion Obama stimulus package of 2009 was spread out over several years; the actual deficit that year was $1.4 trillion.

Any sensible economic analysts thus needs to differentiate between the "cyclical" deficit (or surplus) and the structural one. That is not an easy sum to do since it requires assumptions about the trend growth rate of the economy etc. Nevertheless, if a government deficit falls during a recovery, that is not necessarily a sign of austerity; tax and spending policies may not have changed one jot. The normal cyclical factors may simply be at work.

What about the other sectors of the economy? Look at this chart of the US personal savings rate from the St Louis Fed and you will see that households are not to blame for a saving glut; the savings rate hovered around 10% of income from the 1960s to the early 1980s and is now half that level. The UK ratio is at almost exactly the same level. A low rate policy, it seems, has discouraged people from saving; this may leave them exposed when they eventually retire.



The policy hasn't been incredibly successful in encouraging business investment; as a proportion of GDP, it is below past peaks, and it is now barely growing. Cutbacks in energy spending are the immediate problem but it is a longer-term issue. Perhaps it is down to the money being diverted to buy-backs, perhaps it is because new technology simply requires less capital than old metal-bashing industries, perhaps it is because a slow-growth environment simply discourages capex, as Larry Summers suggests (in debunking the buyback argument). Suffice it to say that low rates may have discouraged personal saving, but have not done enough to discourage corporate saving.

But again, what is the causality? Central banks set very short-term rates and have tried to influence long-term rates via QE but the Fed and the Bank of England stopped buying bonds a while ago, with no apparent impact on yields. As Paul Krugman has pointed out, there is no reason that *desired* savings should equal desired investment. Interest rates are the price at which the two are reconciled. Very low rates are thus a sign that there is indeed a savings

glut. Since so many people/entities want to save, the reward for doing so has fallen sharply.

Where are all these savings coming from? The problem seems to stem from the countries that have big surpluses: Germany, China and the oil producers of the Middle East. Low interest rates in the US and Britain may penalise domestic savers but they don't seem to have much of an effect on the surplus nations. Even here, it is worth thinking about causality; China's surplus may be driven by its lack of a social safety net which prompts its citizens to save more. It is also worth remembering that these surpluses have allowed western governments to borrow cheaply and thus have eased the pain of the downturn. Indeed, there have been recent worries that a decline in Chinese forex reserves might lead to "quantitative tightening" in the global economy.

To sum up, savings are a bit like Goldilocks's porridge; we don't want too much, or too little, but an amount that's "just right". And we need savings to be spread about, rather than lumped in a few places. Most importantly, we do want individuals to save; it is not the folks in Peoria or Peterborough who are responsible for the savings glut.