Funding the Future

# Saving is not the same as investment

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Savings are persistently confused with investing in the UK. In reality, few savings create any real investment in the UK, and that's why our investment rates and economic performance are so poor.

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This is the audio version:

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This is the transcript:

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Saving is not the same as investment. The confusion between those two terms is one of the things that really annoys me about the commentary that is put forward by financial journalists, commentators, and, actually, the financial services industry. If you were to believe what they say, when somebody puts money into a bank account, they're investing.

No, they are not. They are saving.

And if you also listen to those people, when somebody puts money into a pension fund, they are investing in their pension. No, they are not. They are saving in it.

And that is even true when somebody buys shares. That is not an investment. It is a form of saving.

And this needs to be explained because investment is something very different from saving.

Let's be clear why people save, and I'm not saying they shouldn't save, I'm just saying it's not the same as investment.

People save for fundamentally three reasons.

The first one is that they want to put money aside for something that they are going to be doing in the future, and they have the means to put that money aside, of course. In other words, they have income in excess of their needs at present. And, therefore, they're going to put money into some form of account because these days, putting money under the mattress is quite uncommon.

And that account will, they hope, provide them with the store of value so that when the day comes, when they need that money to do whatever it is that they were saving for, they will be able to claim it back. So that's criterion number one for saving.

The second criterion is that people have become, by habit, used to the fact that they will be compensated for saving. In other words, they will either be paid interest if they put the money into a bank account, or they will earn some other form of return, like dividends, if they put it into shares.

This is, again, I stress habitual. It's not necessary. You could actually have a world where somebody would simply keep your money safe and sound, lock it away, or whatever it might be that you wish to think about. But the point is, they will hold your money for you in a place where it won't be lost by mistake, and now, by convention, you are paid a return for doing so.

Some people believe that this motivation of earning interest is fundamental to the savings process. I personally doubt it. I think it's something that people like. I think it's something that suits the wealthy to pretend that it is normal, but I don't actually think it is fundamental to saving. Most people who I know save for a very specific reason; for their old age, for a wedding, that they are planning for a member of their family, or for a deposit for a house, or for a holiday, or whatever else it might be. But there's a goal which is much greater and more important than the rate of return that they will make. And as a consequence, I think that is a decidedly secondary interest, but nonetheless, I mention it because it clearly happens and people talk about it.

And third, when it comes to savings, people want liquidity, by which I mean when they want their money back, they want to know that it will be available to be paid to them. They might agree that they will lock their money up for a fixed period of time, in which case they will only get their money back at a fixed date in the future. But on that fixed date, they will still want to know that whoever they put their money with can repay it. If they have it in an on-demand account, then they want it now, if that's what they decide they need. This again is a fundamental part of savings. We might put money away for the future, but we do definitely want to know that we'll get the money back.

Put those three things together, and you understand most things about savings.

But the fundamental point about savings is that they are financial transactions. The money that is put aside and the money that is returned are all for the benefit of the person who has saved. Precisely what use is made of the money whilst they pass it to somebody else for a period of time, whilst they don't need it, is not a matter of great concern to most savers. In fact, I would suggest that in the vast majority of cases, they are utterly indifferent to what use is made of that money, and the evidence of the financial markets suggests that is the case. There are things like ethical savings funds, green investment funds, and so on, but frankly, they don't appear to appeal to many people.

Most people simply put their money in their own bank or in another bank if it happens to be offering a higher rate of interest, or they need to spread cash around because they've reached the £85,000 limit in the UK where a bank account is guaranteed by the government, or whatever other reason they might have for spreading their cash between institutions, but the point is, they're actually simply looking for a safe place to save where they know they'll get their money back. They probably never ask the question about what the bank does with that money, which is a good thing because, actually, the bank does nothing with that money. I'll come to that point again in a minute.

The same point arises with regard to share-based saving. The vast majority of people who save in shares in the UK, whether it be in their own name or whether it be through their pension fund, are actually pretty indifferent as to which shares their money is put into. In fact, most of them would just like whoever they saved their money with to put it into a mix of shares, which broadly means that they'll get a result equivalent to that on the Financial Times Share Index in the UK, the FTSE 100, or if they're in the States, the S&P 500, or whatever else. They will basically be doing a tracking fund and therefore, precisely which companies the shares are put into is something about which they will have very little knowledge indeed.

There is, therefore, this massive disconnect between the saver and what their money is used for. And I cannot stress this enough because this is absolutely fundamental to the psychology of the financial services industry in the UK. They might try to wrap themselves up as being all sorts of clever things, and they might try to sell the fact that they have lots of different products available, but at the end of the day, the saver just wants three things: to put money aside for a while; to know that they'll get it back; and to earn a bit of money in the meantime, and that's it. There is nothing in that motivation or in the action of the financial services industry itself, which suggests they are in the slightest bit concerned about what use is made of the money.

And let's look at banks as an example. Banks do not lend out depositors' money. This, as a matter of fact is true, and it has been acknowledged by the Bank of England in the UK since 2014, and by the central banks of many other countries as well, including that of Canada and Germany, and many more. Every one of those central banks agrees that the idea that banks take in depositors' money and then lend it out again is complete nonsense.

And let me assure you that because banking is just a double-entry bookkeeping system, and nothing more these days, actually it is technically impossible for your money to be lent to somebody else without your specific agreement because the bank still owes it back to you. Therefore, that has to be what is reflected in the double-entry. There is nothing physical or anything else about the movement of funds between you and somebody else that can ever be recorded in the bank's books.

So when the bank lends money, it does not lend your money. And actually that proves there is a complete disconnect between what you save and the money that might be used for investment, the vast majority of which is created by bank lending.

And it's also true if you put your money into shares. If you buy shares, almost certainly they will be shares that have already been issued by the company, whose name they carry.

The vast majority of companies that are now quoted in the UK, the USA and in Europe, do not issue new shares very often, if at all. In fact, they buy their own shares back from the people who own them much more often than they issue new ones, because that keeps on pushing the share price up by reducing the supply of shares compared to the demand to buy them. And that is a deliberate act on their part because they want to make you believe that buying shares is a good thing.

So when you buy a share, the company whose name is on that share actually gets nothing from the money that you save in the shares that it has created. There is no connection between your saving and the money used for investment.

So let's talk about what investment is. Investment, as I've already noted, is completely unrelated to saving. Investment is expenditure on creating new assets, new training, new resources that are going to be used in the productive economy of a country.

Things like investment in transport infrastructure. Things like investment in power generation. Things like investment inside a company in things like IT or vehicles, or if you are an airline, new aircraft. If you're a government, investment in things like hospitals and schools, but also, and let's be clear about this, in education and training, and that's also, of course, also possible within companies because trained people are needed to produce the goods and services that we want to consume.

All of these things are investment. They're all about creating real outcomes inside the real productive economy.

This is, for example, in my case, this microphone. I've invested in this microphone and the camera that I'm looking into to create this video. Those are investments, and you can think of the same thing in the places where you work or in the communities where you live, and what the benefit of investment is.

Investment is an indication of our hope for the future. There's a risk in investment that, of course, we might not get the return that we expected. This is why capitalists say they take risk. This is why governments sometimes have to take risks because capitalists can't afford to do so, and yet the return is required on behalf of all of us, for example, on things like health and education. And this is literally, as I say, an indication of our belief that we can do things better in the future than we have done in the past. And that is why it is so important, and that is why insufficient investment, which has been a characteristic of the British economy, in particular, for a very long time, is a reason why you end up with an economy that is perpetually in the doldrums, as we are.

So, what is the problem in the UK that I'm referring to when I say that there is this confusion between savings and investments? Well, the confusion arises because everyone is told that saving is investment, and it isn't. And the whole of the City of London is fundamentally focused upon the creation of savings opportunities, and it is not about the creation of funding opportunities for investment.

There is a massive disconnect in this country between savings and investments, which is typified by the fact that we actually have the City of London, described by our current chancellor as the jewel in the crown of the British economy, when savings produces no real social value at all. The function of the City of London is simply to skim off a part of the savings return that people make by putting money aside for an event in the future, which those who organise that savings facility take for their supposed effort in creating it at cost to the person who has saved. That is what the City of London does.

And you could say that this, therefore, is a benefit to the saver, but it doesn't create any new value at all because there is nothing that we can consume as a consequence. And yet hundreds of thousands of people, at the very least in the UK, are engaged in managing saving activity.

It's actually quite possible that as many people in the UK are involved in the direct management of savings as are involved in the direct management of investment, and yet investment is the thing that we really require to create value for society. And so great is our disconnect that we put the emphasis on saving and not on investment, and that's because the City of London has made itself incredibly rich by talking about savings as if it is investment and as if there is social value in it, when in fact they know they're misrepresenting the truth, really because there is no social value to the activity that they undertake, whatsoever, as was once famously said in a report presented to government after the failure of the City of London in the 2008 financial crisis.

So, what have we got to do if we are going to put things right, because we are blighted in the UK by having an excess of savings, and that's because we have such massive wealth disparity between people in the UK, meaning that some have far too many savings for their needs and others have not at all, and we have this socially useless activity taking place in the City of London to try to service those who have excess savings, when in practice we have insufficient investment.

Well, first of all, we have to reconnect investment and savings. In other words, people need to be presented with savings accounts which are guaranteed to actually result in an investment activity taking place.

So I have, for example, suggested that ISA accounts in the UK should only be available if the funds in question are used to invest in the green transition in this country, which will require massive investment in new energy systems, new transport systems, flood systems, things like solar power; you name it, we've got a need for it; changing the way, even, that we produce our food, because that will be a part of that energy transition as well. We need that absolutely direct connection, and it would be possible to ensure that the capital that is saved in ISA accounts by ordinary people could be used to fund that transition. We could literally reconnect savings and investments.

We could also require that the people who hold savings are accountable for the use that they make of them. So banks should be required to write to those who save money with them to say what have they done with the money that they have on deposit, and to explain precisely why, first of all, they don't lend that out, and secondly, to explain their investment policy as well.

Thirdly, we actually do need to look at whether we need to reform the City of London. It is far too big in proportion to the size of the UK economy for the benefit of the country as a whole. We are simply wasting good resources, and in particular, people with talent who are sucked into the City because they can earn so much there, but who add no value for society as a whole, as a consequence. So we have to wonder whether it is time to actually tax financial services more heavily because they do not add value for us.

We also have to look at the tax relief available for savings. ISAs, as I've already mentioned, should be reformed so that there should be a direct connection made between ISA saving and real investment. And if so, tax relief in that case would be justified. But we spend nearly £70 billion a year - a massive amount, bigger than the defence budget, for example - on subsidising pensions in the UK. And yet the vast majority of pension savings money has no connection with investment at all. It is simply dead money saved in secondhand shares or secondhand property or cash, which produces no real value whatsoever.

So we need to reconsider why we are spending £70 billion a year to subsidise something which produces no added value for the economy at all. And that means that we also need to make pension funds accountable for the use that they make of funds so that we can understand precisely what investments they do fund, and I mean investments they do fund and not savings that they make, and that would require that pension funds be vastly more accountable than they are at present.

Most shares are owned by financial institutions, which are owned by people like you and me. We need to know what these financial institutions are doing on our behalf.

They lobby for rules which are against our best interests.

They lobby for tax to be low on companies, which may well be against our best interests.

They lobby for companies to try to save costs, which may well be against our best interests.

They do not encourage those companies to invest because they think that might reduce the financial return paid to them as financial institutions, which they then use to advertise their prowess and success to us as savers.

But the reality is, what we really need is that pension funds should also be accountable, not just for their financial returns, but for the investment that they have made and the value that they have added within the real economy. Then, and only then, will savings be reconnected with investment.

That's what we need if we are to have a thriving, vibrant economy in this country again, and at the moment, the savings structure that we have, which is dominated by the City of London, is completely destructive and is destroying value and is sucking the lifeblood out of the UK economy. And that is a disaster for us, for the country, and for our future, and it has to change.