Funding the Future

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A savings glut creates global economic instability, and that's precisely the problem the world's got right now. The question is, what are we going to do about it?

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This is the transcript:

The world has a glut of savings.

There is too much surplus cash in this world.

You might think that's a problem you'd like to have, but actually, it's causing massive global financial instability, and that's a problem.

The result is that we need to talk about what's going on, where is it going on, how big is the problem, what are the consequences, and what can we do about it? These questions all need answers because the world's savings glut might cause the world's next financial meltdown.

A savings glut is a simple situation where there is more cash, in particular cash, being saved in the world, in excess of the world's desire for investment.

In other words, we are creating global surpluses of income, whether that be household income or business profits, that are not being redirected into constructive investment for the benefit of human beings. The result is that we actually have cash, in particular, floating around the world in excess of anyone's needs.

And that is a phenomenon that is creating real problems. Real problems like asset bubbles and financial crises, and it's also, and we saw this over the last 15 years, forcing interest rates too low, until Central Banks react by forcing them too high, which then creates a tension inside financial markets, which is very hard to manage. This problem is very real and a threat to our well-being.

The idea of a global savings glut was first really recognised by US Federal Reserve Chairman Ben Bernanke in 2005. What he said then was that there were too many savings in the world and they were pouring into the USA from countries with surpluses and high savings rates, and that, he suggested, was contributing to a bubble in US house prices.

Well, we know what happened then. We had a global financial crisis as a consequence. Ben Bernanke was right. These things have the power to destabilise the world's finances. Savings are a problem.

But who is it that's saving too much? Around the world, there are a number of countries which are very clearly doing so.

China is the biggest culprit. It has savings rates that are far too high in proportion to the investment that is made in that country. And there are two factors to this.

One is that Chinese companies are really very profitable. Wage rates are low. Sales potentials are high. Profits are high. Reinvestment is relatively low. As a consequence, China's companies have simply got piles of cash.

But there's another problem in China as well, and that is vast numbers of people need to save for their old age because there is no effective social safety net in that country. There are inadequate pensions, and so it puts aside vast amounts of money. The Chinese people save for their futures in a way that actually creates a cash pile, which has to go somewhere.

There are other countries which contribute as well. Germany and Japan are particular countries where this is a problem. Germany, because it is right in the middle of the EU, of course. It is benefiting from the fact that the whole of the European Central Bank's monetary policy is effectively designed around German needs, and German people are saving in large amounts as a consequence, largely off the back of extracting value from other European states.

But also, they are saving because they, like China, have ageing populations who are worried about their future, and that is the Japanese phenomenon as well. Japan has a very definitely ageing population and a very small birth rate, an issue that we've touched on in other videos of late, and the consequence is very high savings rates for retirement without anybody actually thinking how they're actually going to hire the help they need when these people really are old. Germany and Japan, therefore, are contributing to this issue.

But so too are oil-rich nations. Countries like Qatar and Brunei, for example, make massive surpluses from their oil, and they are quite clearly trying to splash the cash as fast as they can.

We see this in their investment in sports.

We see it in their investment in airlines.

We see it all over the place.

Qatar, in particular, is very good at doing this, but even so, they've got more cash than they know what to do with.

And there are another group of nations which are really contributing to this problem, and they are the world's tax havens.

Money is parked in these places. And before we get too excited about some of the more obscure ones, perhaps the biggest culprits are Luxembourg, Ireland, and Singapore; places that most people don't immediately think of as tax havens, but where the world's corporations go to brush their feet of the excess profits that they have made on which they do not wish to pay too much tax on.

But then we can also add other places like Cayman, and of course on a slightly lesser scale, places like Jersey, Guernsey, the Isle of Man, and so on; all those places that the UK is so keen to promote as locations for corporate profits around the world, as well as the illicit money parked there by so many private individuals.

So, is there a flip side? Of course there is. There are countries who run deficits, some of whom need to run deficits.

The United States is the biggest borrower, but that's not really because it borrows; let's be clear about it. Its $36 trillion national debt does in part exist because people like Donald Trump have insisted on running the US government on the basis of deficits, because he's so keen to give tax cuts to the wealthy. But the real reason why the US runs such a big deficit is because the rest of the world wants to literally buy its dollars. They will give people in the US goods and not actually basically convert the resulting dollar balances that they create into their own domestic currencies, and trade imbalances arise as a result.

So the US ends up as the biggest borrower in the world, and the UK is also a major borrower, and that's partly because our governments, too, by habit, run deficits. But it's just as much because we have the City of London operating almost as a state within the state in the UK, and in that capacity, the UK is dependent upon the kindness of foreigners to run its deficits. But those foreigners, whoever they might be, from wherever they are in the world, are still more than willing to deposit funds in sterling in the UK, and the consequence is that we, too, are significant borrowers.

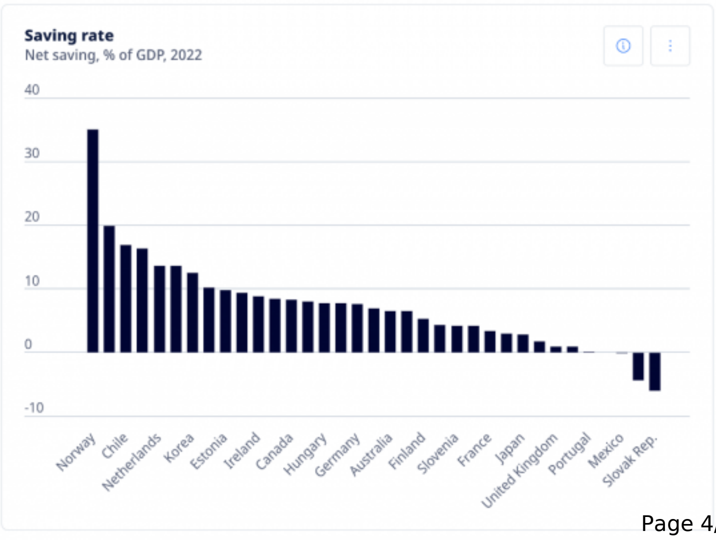
Perhaps more significantly, and I think that we should emphasise this, developing nations need to run deficits. They need to invest. They need to tackle the multitudinous problems that their countries face with regard to a lack of infrastructure, with regard to an incapacity to deal with climate change, to deal with the adaptation that that requires, to promote the education and healthcare that they need. All of those things need investment. But bizarrely, because of the options that are available within the United States, the UK and tax havens, where funds can be located without exposure to real risk, the consequence is that developing nations who need investment aren't getting it.

There is an actual shortage of investment in these countries, even though the world is awash with money, and in the middle of all that the UK is saying it cannot afford to spend 0.7% of its GDP on aid now, and it's cutting that to 0.3%, which just makes the problem worse.

What are the consequences of all this?

There is no doubt that the global financial crisis of 2008 did happen because far too much hot money - cash - moved into that country, needing to find a home, and that money was used to lend to people, to inflate house prices and that created the mortgage bubble which brought the world's banking system to its knees in 2008. That was the flip side of having too many savings.

But there are other flip sides as well. There is, for example, a problem with equality, and to some degree, we can see this in this chart, which is a map of where the savings glut is located.



There are clearly too many savings in Norway. The world likes to say that Norway's Wealth Fund is a great asset, but is it? Is it just a sign that, actually, it's made so much money from oil that it's sitting on a pile of money it doesn't know what to do with? The Norwegian Global Wealth Fund is invested outside Norway and has simply inflated stock markets. Has it really created asset investment? It's very hard to say.

There are other countries in there which are clearly problematic. For example, the Netherlands has a massive savings rate. It is a tax haven.

Korea has a high savings rate because, like China, it doesn't have an adequate social safety net.

Ireland is a tax haven.

Many of these countries that are at the left hand side of this chart, and this is a chart of OECD countries, by the way, because this data is harder to find for the whole of the world on a reliable basis, let alone put up on the screen, but the point is that the countries which are aberrational and have high savings rates do so because they have structural failures within them.

The countries that are saving normally, Canada, Hungary, Australia, those that are in the mid-range, they're not creating much difficulty by having a 5%, or thereabouts, savings rate.

The countries at the right-hand end, Mexico in particular, need to run deficits to deal with the problems that they face. So we have a problem. And we basically have a glut, which is why there are so few in deficit and so many in surplus. We need to understand that.

So, what is the consequence of this, and how do we manage it?

The consequence is instability.

We manage it by trying to reduce savings.

That is the consequence that all these countries that have savings in excess of their needs to make actual investments in their real economies need to address unless they are willing to redirect the funds constructively to developing countries.

So reducing savings is essential.

The reduction in financial flows which might cause harm is essential.

We need to increase real investment.

And we need to reduce the risk of financial meltdown.

How do we do that?

First and foremost, we need to create the social safety nets that will make sure that people feel secure in their future.

That is vital. Without that, China will still see these surpluses and so will other countries like Korea, and Japan, and Germany, and so on.

We need to correct for that.

We need to increase pensions for older people, so they do not need to save as much.

We need to tax wealth more. This is an issue that I tackle often, but it's a simple, straightforward fact that unless we do redistribute wealth within countries by using taxation as the tool which is most readily available for this purpose, there will be excess savings, and those excess savings will destabilise economies.

We need to increase aid to developing countries.

We have to do that to make sure that they can really invest, which is the necessary flip side of this saving surplus.

And, of course, we still need to tackle tax havens, not because they might now be a problem with regard to their opacity, because to a very large degree, that problem has been solved, partly as a consequence of work that I did, a decade or so ago with the OECD, to open up these places so that we know who saves in them and which companies use them. But they still exist as locations where excess savings are stored, and that is a difficulty. They are instruments for the savings industry, and unless we solve that problem, they will still create financial instability.

And we need to tackle the problem of reserve currencies: the problems in the US in particular, but also in London.

And we need to tackle the problem of having a major financial centre in London, which is the particular problem that the UK faces.

Ultimately, though, we need to increase investment. Investment to save the planet with green, tax-incentivised funds.

We need to invest more in housing that people need.

We need to invest in those things that will tackle the harms that are already locked in as a consequence of climate change, and in particular, things like flood risk.

We need to invest in education and healthcare, particularly in developing countries, so that pressure for migration is reduced.

We therefore need to increase the income of those places, again to make sure that people do not want to migrate in the way that we are seeing, and which is causing social stress.

We need, in other words, to reduce inequality, within and between nations.

And we need to look at what this means for growth. Not growth for growth's sake, but growth for the sake of tackling the world's needs.

That does ultimately depend upon our ability to tackle climate change.

But there is no shortage of tax revenues to deal with these issues. The world's savings are not taxed enough. We could tax them more. We could, as a consequence, collect all the money that is required to ensure that, literally, the world's problems can be solved.

The world's savings glut is, at present, causing a massive problem. It could, if we addressed it properly, be the source of our salvation. These resources could be put to good use. The choice is available to our politicians. The question is, will they take advantage of this situation?