The Looting of Savers

Contributed by Martin Hutchinson
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The French and Greek elections have made the “austerity” programs favored by Angela Merkel and other sensible policymakers seem politically highly unattractive (never mind that the spending cuts proposed by the austere have almost universally not happened, while tax increases have been onerous). Consequently, Keynesians worldwide are recommending further bouts of government spending combined with partial repudiation of debt. Like the disgraceful monetary policies also peddled by these people, these recommendations amount to the wholesale looting of savers in favor of profligate borrowers and bloated public sectors. It’s worth reminding ourselves of the long-term consequences of such folly.

One of John Maynard Keynes’ principal crimes against sound economics was his demonization of savers. Calling for the “euthanasia of the rentier,” he proposed the paradox of thrift, whereby savers in a recession are supposed to damage the ability for the economy to recover by depressing aggregate demand. Like Keynes’ equally spurious calls for increased government spending as a stimulus, this demonization of savers has been used by intellectually dishonest politicians of the left and squishy center to justify policies that have the effect of robbing savers, whether through inflation, excessive taxation or repudiation of government debt.

In reality, saving is the essential precondition for capital investment, and therefore for economic growth. Societies with inadequate savings cannot generally pull themselves out of poverty, however abundant their natural resources. You only have to look at the track record over the last half century of Asian societies, which mostly have a high cultural propensity to save, compared with Latin American societies that do not. Whereas countries like Argentina or Brazil were richer than Korea and Taiwan, little poorer than Singapore or Japan and far richer than China in 1960, today the comparison has reversed.

One of my major objections to the activities of the World Bank and the IMF is their downgrading of the importance of saving. Those institutions frequently propose high taxes on investment returns, and seem to be under the impression that the only way to start a new company is with a government grant or an investment by a major international private equity fund, such the World Bank’s offshoot the International Finance Corporation. As the Solyndra example in the United States showed, the government is an exceptionally bad venture capitalist. In addition, it can be stated with considerable confidence that enterprises that require $500 million up-front investments before having made a profit or even significant revenue are very unlikely to succeed in the long term.

Middle class saving is the key to enterprise formation in any society. Even when venture capital companies exist, as in the United States, they rapidly get drawn away from genuine venture capital towards the much easier money available in leveraged buyouts. Mitt Romney’s Bain Capital, for example, began by providing genuine venture capital to Tom Stemberg’s Staples, but rapidly discovered that most such investments were too small and the returns too slow, and switched to leveraged buyouts. The vast majority of new ventures, innovative or not, depend on the savings of their founders and their founders’ network of relatives, friends and business contacts, to get going before institutional venture capitalists will look at them.

Nurturing middle class savings is thus the most important task of government. John Locke said “Government has no other end, but the preservation of property,” and he didn’t overstate the position by much. Quite my most gratifying banking experience was designing a simple bond law for the Republic of Macedonia, which allowed 800,000 Macedonian savers, whose savings had been expropriated ten years earlier by the former Yugoslavia, to get most of their savings back immediately. The country’s improvement in economic performance following the implementation of that law has been marked, and extremely pleasing.

Worldwide monetary policies, in place now for almost four years, are uniquely unkind to savers. By forcing interest rates, both short-term and long-term below the rate of inflation, they force savers to receive a negative real return or take large risks to achieve a positive one. That’s the reason for the success of speculative bubbles like that in Facebook shares, which have created a market capitalization larger than General Motors off a stream of advertising revenue only 4% the size of the company’s market capitalization. One commentator described the Facebook IPO as the largest “pump and dump” in stock market history. It has a lot of company for that distinction (when normed by contemporary gross domestic product). Certainly the South Sea Company and the Mississippi Company, those twin British and French bubbles of 1719-20, had more commercial reality to them. After all Robert Knight, the South Sea Company cashier, who absconded to Antwerp with the company’s records, appeared before potential investors in a well-powdered periwig, not a hoodie!

The latest Keynesian solution to the unwillingness of debt markets to finance further bouts of government spending is to spend yet more money, but to finance it by monetary expansion and partial repudiation of debt. This would get debt levels down, but would close the markets to further debt issues, since investors are not so foolish as to lend to borrowers who have already defaulted on their obligations. Even Argentina, which has enjoyed a remarkable economic boom since defaulting on its debt in 2005, has not been able to return to the capital markets, much to the surprise of its leaders. Thus this approach, if undertaken directly, is unlikely to lead to success.

There is however an alternative approach, which currently appears more and more attractive to distraught Keynesians, and that is financial repression. Under this technique, which was most successfully applied by the British government to work down its excessive debt level at the end of World War II, regulations are used to prevent domestic savers from moving their money into international assets. Monetary authorities are then encouraged to promote inflation, to the extent that domestic interest rates are kept below the rate of inflation. Using this technique, governments can run deficits for a generation or more, while the value of their debts is reduced by inflation. Add in a stiff income tax, to penalize further the nominal interest returns of savers foolish enough to buy government debt, and the government’s debt position can be retrieved quite nicely over a 20-30-year period – at the cost of the nation’s savings and the rest of the economy. Needless to say savers, especially those fool enough to believe in the government’s promises to maintain a sound currency, were robbed blind and ended their lives impoverished.

Repression is clearly in the sights of the left at this time – after all, savers generally tend to vote for the right. The idea of looting their political opponents to increase public spending, while having that looting proceed invisibly, so that their fingers are not on the weapon, is attractive to leftist politicians everywhere – it is in a sense THE central flaw of democracy. Of course, the most blame should attach to those politicians like Harold Macmillan, Richard Nixon and, it increasingly seems likely, David Cameron, who rely on savers’ votes to get elected and then betray their own supporters.

Fiscal austerity is needed, but as France and Greece have shown, it is unlikely to win its proponents much electoral support. That is particularly the case if, as in Britain the austerity consists primarily of tax increases, so that the economy declines while the deficit remains unaffected by the apparent austerity. In any case fiscal austerity alone is not enough. If it is not combined with sound monetary policy, savings rates will decline and the savings pool itself will be drained by negative real interest rates. In the long term, that can only lead to impoverishment; in a globalized world, the skills of Western employees are not so superior to those in emerging markets that they can expect to retain higher living standards without a healthy pool of capital to accompany them.

The need now is thus for a revolution in monetary policy, that raises the risk-free interest rate well above the rate of inflation, and allows savers at last to receive a real return on their money without investing in the likes of Facebook. It probably won’t happen until inflation gets seriously out of hand, so my advice to savers is this: make sure a substantial percentage of your money is in gold, in order that you will survive the painful burst of inflation that is needed before global monetary authorities are brought to their senses.

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