Acornomics – Fallacies about Economics and Saving

Keith Rankin, 25 October 2013

Communication about economics has a number of blind spots. As a result, most people who have learnt a little economics tend to subscribe to a form of popular economics that I call 'acornomics'. And that understanding tends to rub off onto those who have no formal knowledge of economics.

We see this in particular when journalists, politicians and finance sector professionals discuss topics that use the words 'saving' and/or 'investment'. For example, acornomic thinking – or 'nest-egg syndrome' – completely dominates the debates about retirement provision.

One of the universal icons of the saving industry is the squirrel. When I was at primary school we had a school savings scheme, run by the Post Office Savings Bank (Kiwibank's precursor), called Squirrel Savings Accounts.
(see http://www.kiwifamilies.co.nz/articles/childrens-savings-accounts/)

British squirrels save by collecting acorns, their main food source. They're making provision for their futures. The more correct word for this activity, however, is 'hoarding', not 'saving'. Hoarding can never generate interest payments. Indeed hoarded goods, such as acorns, depreciate, implying a negative rate of interest. Yet, somehow, I still got my three percent interest on my Squirrel Savings Account. (What were those stashed acorn-coins getting up to!? From ancient history, the concept 'interest' derives from animal reproduction.)

Essentially squirrels acquire goods with a long lifespan, rather than foods that must be consumed immediately. They enhance their security by choosing to abstain from immediate consumption, 'buying' more preserved food and less fresh food. The equivalent in human behaviour would be buying and stashing canned food and spare consumer goods, much as survivalists and doomsday preppers do. Or preserving peaches, as our grandmothers or great-grandmothers did.

I have visions of prudent retired persons today eating their 30-year-old baked beans, and wearing, as new, that spare pair of trousers bought in the 1970s. Cool.

Hoarding behaviour is like saving in the sense that it is giving up present consumption in favour of future consumption. And it's like investment in the sense that the hoarder is investing in inventories, much as antiquarian bookshop proprietors might invest in stock that they don't expect to shift anytime soon. (Certainly I have books bought last century that I have yet to read, but would still like to!)

Saving, by definition, is simply non-spending. Buying cans of baked beans instead of fresh vegetables would not normally be classed as saving by a modern economist.

However, saving is closely related to investment, a form of spending. Investment is essentially planting for the future, rather than hoarding for the future. (Hence the machinery in factories is often called 'plant'.) In a one-man "Robinson Crusoe" economy, saving is equal to investment, by definition. For example, if Crusoe has a potato crop, he can save some of his potatoes and plant them, thereby giving himself a source of fresh food in the future.

In simple economics, the presumption continues of this equality of saving and investment. All unconsumed goods are planted, as capital, assuring a supply of new goods in the future. If we choose to save more, and therefore plant (ie invest) more, we can have more new goods tomorrow than we have today. Economic growth in a nutshell.

That growth dividend forms the basis of the modern concept of 'interest'. Thus interest is a reward for both present abstinence and risk-taking. Planting (contrast with hoarding) is always a risky activity, be it planting new trees from acorns, or building factories.

The problem that arises is that we get in the habit of thinking about money in the same way that we imagine squirrels regard acorns.

Money is not wealth, whereas acorns are wealth. Money is a claim on wealth.

If we don't use the money we earn this year to buy all of the goods and services that our income entitles us to buy, then someone else must consume or invest those goods and services which represent our saving. Otherwise our saving goes to waste. Money under the bed is not like a stash of acorns, or eggs in a nest. Rather, unspent income today is both someone else's debt today and a claim on somebody else's income tomorrow.

Thus, with unspent money, we enter a credit-debt relationship; something neither the squirrel nor Robinson Crusoe did when they saved. Whoever consumes the goods and services that you did not purchase becomes a debtor, and you become a creditor.

Usually, when we save money, we lend it to the bank or to some other financial intermediary, such as a Kiwisaver provider. Frequently, that intermediary (or we ourselves) buys some existing asset (rather than creating a new asset). That's not investment; it's simply putting part (principal) of our income into somebody else's hands (as debt), with the expectation that those somebodies, will on future dates put even more (principal plus interest) of their income into our hands (debt service).

We know, deep down, that the sum total of all the world's monetary nest eggs vastly exceed any capacity of present or future productive communities to service. These financial quasi-acorns, and the attached compound interest that our human squirrels expect as an entitlement, represent largely unsatisfyable claims hanging over future producers.

From the point of view of acornomics, these financial assets are called 'wealth'. In reality they are no such thing. They are neither present wealth nor future wealth. Rather, they are claims on goods and services that may or may not be produced in the future. Such claims can be realised as actual wealth – that is, as goods and services – so long as only a small proportion of claimants actually exercise their claims.

What will happen in the second quarter of this century when we actually try, en masse, to spend these retirement 'savings' that turn out not to be like eggs in a nest, acorns in a stash, or baked beans in a bunker? The risk is that these pieces of paper – or their electronic equivalents – will be as worthless as most US shares were in 1932, or Russian bonds were in 1918.

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