

Speculation: Vanishing Acts, Financial Instability, Geopolitics

Keith Rankin, 21 March 2014

'Speculation' is generally understood as a pejorative word, as in "that [idea] is mere speculation", or "speculation is ruining the economy". Actually, speculation is generally a good thing; it is the essence of the deductive method through which almost all our intellectual breakthroughs have arisen. In particular, informed speculation – or speculation conducted by an open and liberally educated mind – is an essential component of the liberal democratic intellectual tradition. And financial speculation has both good and bad sides.

Here are three topical stories in which speculation is a central theme.

Malaysia Airlines MH370 (8 March 2014)

This is already looking like the greatest aviation mystery of all time. In SE-Asia, the seas are very shallow, and very busy with economic activity. Aircraft accidentally crashing into the sea almost always leave debris. This was a moonless night, in which even low-flying aircraft without lights would be difficult to see.

By Sunday 9 March, I became aware that the loss of Silk Air 185 over Sumatra in 1997 was likely to prove the nearest precedent. In that flight it is generally accepted that the Captain crashed his own aircraft, even though that verdict remains too raw for many to accept.

Brief research has confirmed that there is a growing suicide epidemic among middle-aged men; especially the cohort of men born between 1955 and 1975. And there are links between suicide and, for want of a better word, 'geekiness'. As shown in a recent *Al Jazeera* 'People and Power' investigation, India's IT capital, Bangalore, is also India's suicide capital. In the US the most prominent geek suicide was probably that of Aaron Swartz, founder of Reddit.

Closely aligned to geek culture is 'hacker' culture. Hackers like to crash sophisticated computer systems in order to both show their own cleverness and to expose weaknesses in those systems. Many see a greater good in the bad things that they do. Their lives are somewhat one-dimensional; their hobbies are almost identical to their professions.

The captain of MH370 seems to have been a brilliant though somewhat obsessive pilot. Aviation was his profession and his hobby. He possibly saw weakness in the human-technology interface of modern aviation, and may have become convinced that it would be quite possible for a clever pilot to stage the complete disappearance of a modern jetliner. Indeed he may have felt that the only way to communicate this weakness was to demonstrate it.

The middle of the Indian Ocean would be just about the hardest place in the world to detect a craft that had sunk without trace.

Regardless of whether this speculation is even close to the truth, we need to address the issues around the mere possibility of pilot mal-intent. Security measures designed to keep intruders out of aircraft cockpits may have gone too far. We now know how easy it is for a pilot to turn off an aircraft's transponders, and to prevent others from entering the cockpit. What control does a pilot have over the conditions in the cabin? Can he create an unsurvivable environment in the cabin while maintaining a survivable environment in the cockpit?

No system should ever be so vulnerable to the human whims of just one person. Clearly senior cabin crew (and co-pilots) need to have independent means of communicating with planet earth, even if it's just an alarm button with GPS information. And cabin crew have to be able to enter the cockpit if there is a possibility that the pilots have become disabled.

We can learn much from this episode even if we never solve the mystery. It's just about asking and answering the right "what if" questions. That's the benefit of constructive speculation.

Financial Instability

The word 'speculation' is at its most pejorative when it's used to mean the so-called investment activities that involve buying existing assets (equity or debt) at one price with the intent of selling at a higher price; or selling such assets at a high price with the intent of repurchase at a much lower price.

Speculation is the essence of finance as a discipline. And it can be beneficial. The process of profiting by exploiting price discrepancies is understood also to be the mechanism through which those opportunities are closed. A key problem is that a large proportion of people who trade assets focus on price movements rather than on price levels. Buying less because prices are high is a stabilising strategy. Buying more of assets whose prices are seen to be 'rising' rather than merely 'high' is a popular though destabilising strategy. Success in finance is not only about assessing whether prices are above or below their 'fundamental' levels, but about knowing what strategies other market players are following. If you fail to go with the crowd at the beginning of a financial bubble, your professional performance looks very uncompetitive.

One popular area of speculation is in residential real estate equity. It's so bad in Auckland that, to buy a property you have to pay prices driven up by speculators pursuing the destabilising strategy that presumes rising prices will continue to rise. Foremost among those speculators are the banks who, as interest rates rise, increasingly favour lending to speculators wanting to mortgage existing assets rather than entrepreneurs who want to produce new goods and services.

Such speculation is bad for renters as well as for first home buyers. Speculators, often through property managers, use tenants as a source of income and day-to-day property maintenance, but do not really form relationships with their tenants. Thus tenants become pawns in a game of financial chess, and have to move house at the whims of their speculator landlords. Moving house every two years or so probably adds at least ten percent to the cost of renting.

Finally, on the issue of financial speculation, we have monetary policy. In a globalised world, the 'law of one price' is supposed to apply. It means that interest rates around the world should converge, with differences between countries understood to be due solely to differences in the risks of making loans to banks, businesses or governments in the various countries.

Yet the recent actions of the Reserve Bank are to create divergence between the interest rates in New Zealand compared to the countries in which most of the world's saving takes place. This creates a speculators paradise; the monetary authorities in New Zealand are extending what already amounts to a one-way bet. Borrow in Europe, USA or Japan, and lend to New Zealand banks. In the process, the whole mechanism of floating exchange rates is undermined. Current account deficit-debtor countries such as New Zealand experience rising exchange rates, whereas surplus-creditor countries such as Japan, Germany and Sweden experience lower exchange rates; quite the opposite of how floating exchange rates are meant to work.

The creation and perpetuation of interest rate divergence leads to an accommodating though ultimately destabilising financial process; a process that induces residents of spender-deficit economies to spend more (by inflating asset prices in these countries), and reinforces the non-spending propensities of residents of miser-surplus countries.

Geopolitics

On 10 February I heard an [interview](#) (Afternoons, *Radio New Zealand*) with Cambridge University historian, Nicholas Boyle: "2014, How to Survive the Next World Crisis". The interview related to an informed piece of

speculation on Boyle's part, that critical events, such as the Battle of Waterloo and World War One, often took place in the second decade of a century, giving each century its defining imagery and colour.

Boyles's argument is that we haven't quite left the twentieth century yet, but may do so soon. The obvious challenge was to imagine a major geopolitical event – possibly a blue-sky (or 'black-swan') event – as being immanent. Do tensions in East Asia today parallel tensions in Europe prior to World War 1? Interestingly, at the time of the interview, Ukraine was at the height of its revolution, but the geopolitical implications of that unrest were unexplored in the media. We should not have been as surprised as we were when Russia intervened in Crimea to take-back what it (and many Crimeans) believed to be really a part of Russia.

In a more recent interview (Nine to Noon, *Radio New Zealand*, 25 February), Kathryn Ryan [spoke to](#) Canadian historian Margaret MacMillan, author of 'The War that Ended Peace: How Europe Abandoned Peace for the First World War'. In a wide-ranging discussion, the topic of Britain's entry into that war was mentioned only peripherally. In fact, from our point of view, it's Britain's (and hence our own) participation in that defining (for us) event that's a mystery that can be further explored by constructive speculation. (Interestingly, I see that Niall Ferguson is arguing that Britain could have and should have stayed out of that War; see '[Britain entering first world war was "biggest error in modern history"](#)' *Guardian*, 30 January).

At its core, World War 1 appears to have been a conflict between Germany and Russia. France got involved to protect its interests in Russia, and Britain had its interests – including emergent oil interests – in the Middle East to protect. The Turkish-centred Ottoman Empire was in a state on immanent collapse, and it was clear that any war between Russia and Germany would eventually become a war over the spoils of the Ottoman collapse. Britain was never going to miss out on that division of spoils. It was no diversion that led New Zealand troops to Gallipoli. The Turkish campaign was absolutely central to the geopolitics of the time.

I will make a few speculations inspired by these radio interviews. First, I believe that the years that defined the beginning of the 21st century were 1989-90. That was when the Cold War ended, about when the Internet began (the world wide web celebrates its 25th anniversary this year), and when China signalled that it would do capitalism its own ruthless way. It was the end of Apartheid in South Africa. And 1990 represented the beginning of the end of Japan's status as a global economic superpower.

The transition decade was the 1980s, when the economic certainties of the twentieth century were overthrown by a return to economic laissez-faire, and when the Ayatollah Khomeini became the face of a geopolitical dynamic to replace the Cold War; a dynamic that has inspired an anti-western Jihad that gave us Pan Am 103, the Taliban, and New York 9/11.

I see the events in Ukraine as a working through of events that began in Eastern Europe in 1989. And I suggest that the critical geopolitical issue this century will be the sanctity or otherwise of present international boundaries as the nation state itself wilts as the world's pre-eminent institution. Unless there are dramatic improvements in the Ukrainian economy, Crimea may not be the only part of Ukraine that wants to join Russia.

I don't think that World War 1 was the event that defined the beginning of the twentieth century. Rather I think the key events were the developments of the internal combustion engine, which gave us the motor-car, and the electric motor. Cars and electricity, and then aviation, are what the last century was all about. World War 1 reflected the fact that Germany played a critical role in this 'second' industrial revolution, and that German nationalism reflected Germany's status as an emergent imperial super-power. Indeed the German empire extended as far as Samoa.

The century before that (the 19th) was ushered in by the French Revolution (from 1789) and the emergence of steam power; not by Waterloo. And the century before that was presaged by the scientific and financial revolutions in the 1680s and 1690s. For me the 18th century began with the English 'Glorious' Revolution of 1688 that ushered in constitutional monarchy, British hegemony, central banking (initially a

means to manage government debt), and the anti-state liberalism of philosopher John Locke that created the belief system that underpins modern neoliberal economics.

My speculative argument is that century-defining events have taken place generally about a decade before the chronological beginnings of these centuries. Indeed, if we go back further, 1492 was a defining year for the 16th century, with the European discovery and subsequent exploitation of the Americas, and the final Christianisation of Europe extinguishing the 15th century.

Speculation is central to human endeavour. The speculative impulse arises from our needs to explain, to exploit and to compete. Speculation is central to the spirit of risk-taking and asset acquisition that both underpins and destabilises our capitalist world.

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