Zero-Sum Financial Reality: (+X) + (-X) = 0

Keith Rankin, 19 May 2015

The Greens astonished me on Sunday (Scoop transcript of Metiria Turei interview, Q+A, TVNZ 17 May) by proposing a children's Kiwi Saver as part of a plan to boost New Zealand's saving culture. (Winston Peters also astonished me on the same programme by saying that we in New Zealand invented the term South Sea Bubble. This was actually an equity bubble in London – linked especially to shares in the speculative South Sea Company – that burst in the year 1720; a big year for Isaac Newton's financial balances - losing the equivalent of half a billion dollars today – but not a significant epoch in New Zealand history. Newton made a lot of money working for the Royal Mint!) I also noted Russel Norman talking about the need to invest in the 'productive sector', on Radio New Zealand this morning.

The Greens seem to be embarking on an early-1960s' style growth campaign. (Yes, I had a school 'squirrel' savings account in those years.) The ideology was to maximise the rate of economic growth, and the belief was that the rate of household saving was the principal determinant of the growth rate. Political Economist Conrad Blyth gave an account of this growth-maximisation ideology in 1966 (The Special Case: The Political Economy of New Zealand, *Political Science*). It's Blyth's final model of four: "growth, planning style".

Financial balances represent an accounting 'zero sum game'. My title 'equation' – (+X) + (-X) = 0 – is an accounting tautology, true for the global economy. It says that the sum of all financial surpluses (+X) must, by definition, equal the sum of all financial deficits (represented as -X). It's best to consider various sectors of the economy to appreciate the significance of this simple accounting principle.

In my Government Deficit Phobia (16 May), I suggested six sectors. Here I refine this, to five:

1. Normal household sector.
2. Normal business sector.
3. Government sector.
4. The poor and the young.
5. Speculative sector.

In the simple 1960s' economic growth model, normal households ran structural surpluses and normal businesses ran deficits. ('Structural' essentially means 'almost every year', and autonomously determined.) The other sectors either balanced, or (the speculative sector) were presumed not to exist.

These business deficits – called investment in the 'productive sector' – were the engine of economic growth. Business debt as a percentage of GDP would be stable precisely because of the growth that those deficits were presumed to engender. This was a growth maximisation model, so the policy challenge was to increase X, the household sector surplus, so that the business sector deficit could also increase, so that the rate of economic growth could increase.

What Turei is saying is that +X should be bigger than it is at present. And Norman wants those normal business deficits to be bigger.

The political economy of the twenty-first century is very different from the early 1960s. That growth model was abandoned in the late 1960s as unrealistic and unsustainable. Indeed the origins of the Values Party – the Greens' forerunners – was a feature of that seismic shift in economic perception and reality.

This century, both the normal household sector and the normal business sector run structural surpluses. Appropriate and sustainable economic growth can be funded entirely from the surpluses – a mixture of business debt repayment and corporate saving – of the normal business sector. The challenge of this century is about which sectors (other than normal business) should run deficits. Should it be the government sector, the poor and the young, or the speculative sector who borrow to purchase existing assets on secondary markets, thereby inflating the prices of those assets?

All three of these deficit outlets for the structural surpluses have played significant roles this century. Japan, which briefly entertained the mother of all speculative sectors in the late 1980s, has gone for government deficits as the most sensible option. In New Zealand, where government deficits in the last twenty years have been small or non-existent, we recognise the 'poor and the young' and the 'speculative sector' as the deficit sectors of preference. We also note that New Zealand as a whole represents part of the global deficit sector. The force of structural household and business surpluses in Asia and northern Europe overwhelms us, and resistance to that force (Labour policy) would only contribute to the next global crisis.

The Greens, naively, want to raise the value of 'X'. The global financial problem is that X is too big. The problems of the world economy can only be solved if X (combined household and business structural surpluses) gets smaller. While a smaller X is not a sufficient solution, it is a necessary part of any transformation to achieve a stable, equitable and sustainable economy. The Greens seek to aggravate rather than to ameliorate global imbalances by raising structural household surpluses.

In the meantime, that high global value of X – it's high in New Zealand as well as overseas – combined with the resistance of governments to run deficits, is the fuel that drives the speculative sector. (South Sea Bubble 2.0?)
