THE ECONOMIC CRISIS:
THE PROBLEM IS NOT SAVINGS, BUT INVESTMENT

Bill Rosenberg

The economic crisis is your fault and mine, the government tells us. It's all because I and you haven't saved enough. This is economic nonsense which is nothing more than a game of passing the blame.

There are in fact two economic crises affecting Aotearoa at present. One was completely foreseeable: the current account deficit. It has been on its way for a long time. The other is the Asian crisis, long – and accurately – predicted by critics of open slather free markets, but a highly embarrassing bolt from the blue for the government, the police of the international "free market" such as the IMF and World Trade Organisation, and their advisers.

If objectively considered, both should lead to fundamental reversals in current government economic policy and in the policy enforced by those international institutions. They won't, because "economic rationalism" is not rational. For Aotearoa, the solution to neither crisis is for us to save more. It is to control our economic relationships with the rest of the world, and in particular, control foreign investment.

Crisis number one: the Balance of Payments

The Balance of Payments is the part of the national accounts that shows the balance between what the country receives and pays abroad. There are two parts to it. The "current account" shows the balance of the country's payments for imports and exports of goods and services, and for "invisible" income, such as dividends and interest payments. That's a little like your annual income and day-to-day expenses. The "capital account" shows capital movements: investment (including lending) into and out of the country, and repayments of debts. That's like your purchase of a house and repaying the mortgage.

When the current account goes into deficit – indicating the country's payments abroad are beyond what it can afford from the year's external income – the "current account deficit" must be made up by overseas borrowing.

Snowballing overseas debt

So recurring current account deficits signal that the country is getting further into overseas debt. Coincidentally, at about the same time as the first quarter current account deficit of $7.07 billion, or 7.2% of GDP, was announced, we were also informed that overseas debt had just jumped to yet another record – just a shade short of $100 billion, just over 100% of GDP. If we completely stopped all imports of goods and services for three and half years, it would still not be paid off (see table).

New Zealand's Overseas Debt

Year to March	Overseas Debt $Million	GDP $Million	Exports of Goods and Services $Million	Ratio of Overseas Debt to : GDP %	Ratio of Overseas Debt to : Exports %
1994	72,545	80,793	25,044	89.8	289.7
1995	69,975	86,543	26,932	80.9	259.8
1996	75,425	91,207	27,217	82.7	277.1
1997	79,593	95,112	27,330	83.7	291.2
1998	98,998	98,478	28,027	100.5	353.2

Source: Statistics New Zealand. All data are from their June 1998 release on Overseas Debt except for GDP and 1998 Export data which come from Hot Off the Press, Balance of Payments: March 1998 Quarter.

Of the March 1998 overseas debt, 41% was due in the next 12 months, yet it would take 18 months of exports to repay. Of that 1998 debt, 80% was owed by the corporate sector, 20% by Government.

Both the deficit and the debt are at levels justifying high concern amongst even the most stalwart defenders of free market policies. For example, the IMF definition of "Heavily Indebted Poor Countries" (the most desperate of the developing countries) includes low income countries with "present value of debt to exports higher than 220 percent or present value of debt to GNP higher than 80 percent"[1] (see for exam-

---

[1] The IMF uses the measure "net present value" of a country's debt, rather than its face value. The IMF says this tries to take account of the concessionary interest rates (and hence lower cost of debt service) that developing countries may have for some of their debt. It is not possible to calculate the net present

ple the IMF's Web site, http://www.imf.org/external/pubs/ft/pam/pam51/annex.htm). New Zealand's position is worse on both these criteria.

Even Donald Brash, Reserve Bank Governor, indicated his concern ("New Zealand's economic reforms: A model for change?", a speech by Donald T. Brash, Governor of the Reserve Bank of New Zealand, hosted by Chatham House, the Waitangi Foundation and Prudential Corporation at the Guildhall in London, 3 June 1998). Despite being on record as saying he saw no problem if New Zealand's assets were entirely foreign owned, he indicated that he has now revised that view, because of concern, first at a possible political backlash at large-scale overseas ownership, and second, at the crisis (the "considerable social and economic cost") that would occur if foreign investors "decide that enough is enough" because of the high current account deficit.

Balance of Payments Major Components

Year ended March	Balance (inward less outward payments, in $million) on: Goods	Services	Inv Income	Transfers	Current a/c	GDP	Ratio of Current a/c to GDP
1994	3,136	-899	-4,521	1,470	**-814**	80,793	-1.0%
1995	2,092	-591	-5,955	1,811	**-2,644**	86,543	-3.1%
1996	865	-160	-5,999	2,462	**-2,832**	91,207	-3.1%
1997	892	-605	-7,112	2,306	**-4,520**	95,112	-4.8%
1998	**1,027**	**-1,141**	**-7,735**	**776**	**-7,073**	**98,478**	**-7.2%**
94 to 98	8,012	-3,396	-31,322	8,825	-17,883	452,133	-4.0%

Source: Hot off the Press Balance of Payments: March 1998 Quarter, Statistics New Zealand.

The current account deficit is in a vicious circle. Not only does it lead to more overseas borrowing (or equity investment) and indebtedness, but that investment and indebtedness is the principal cause of the deficit. As the table shows, Aotearoa is running a falling surplus on its trade in goods, an increasing deficit on its provision and purchase of services, and a healthy surplus – which fell substantially in the last year – on "transfers" (mainly financial transfers by migrants and government). But there is a rapidly growing deficit on foreign investment income which dominates all the other components. I'll return to this below.

To remove the deficit either exports of goods and services have to be increased, imports reduced, or payments to overseas investors reduced.

If saving is the answer, what was the question?

So how can saving more help this? The superficial answer given by, for example, the Treasurer, Winston Peters, is that more saving will reduce the need for foreign investment and hence reduce the payments to foreign investors. But that does not bear examination.

When people talk about "saving" they think about putting money in the bank, into superannuation, or under their mattresses for future use. In other words they decide not to spend some of their income. The only sense in which this helps the current account deficit is that it reduces imports because some of that income would have been spent on imports.

It is the same logic as reducing incomes: wage cuts. What it points out is that the next step if people don't save will be a new attack on wages, rather than on investor income. Having progressively given away all other means of controlling imports – import controls, tariffs, preference to local producers – in its policies and international agreements, the government's only means to control the balance of payments is by cutting people's standard of living.

---

value of New Zealand's overseas debt without detailed knowledge of the terms of the loans involved, but since almost all of New Zealand's debt will be at market rates, its net present value in the IMF's terms should not differ greatly from face value. It also uses GNP rather than GDP. GNP is GDP less the part of the country's income that goes to overseas residents, net of equivalent income from abroad. In other words, while GDP is the total output of the country, GNP is the part that remains in the country and directly benefits New Zealanders. In New Zealand's case, GNP is therefore significantly lower than GDP, and debt ratios are even worse: e.g. the current account deficit was 7.8% of GNP in 1998.

Individuals are not the only ones that save though. A large proportion of savings nationally are made by the government (from taxes and other earnings) and companies (from income not distributed as interest or dividends). Showing its disbelief in its own rhetoric, the government is currently "dis-saving" by giving people tax cuts, most of which will be spent rather than saved. The commercial sector is doing the same, the AMP float (much heralded as a saviour of the economy) effectively dissolving the savings of policy-holders past and handing them to policy-holders present, as shares, many of which will be sold. Even if some of the proceeds are saved, they will be less than the 100% saving had they remained in AMP. Other companies (including Telecom, Tranzrail, and DB) have similarly "dis-saved" by various forms of return of capital to their shareholders. A more insidious form of savings reduction is the tendency to pay an increasing proportion of company earnings as dividends rather than retain them in the company. Telecom for example have a policy of paying out 70% of earnings.

However, to confuse matters, economists have borrowed the word "savings" for use in another context. The word "Savings" (I'll use a capital "S" to emphasise the difference) is used in the National Accounts to mean the difference between all income and all expenditure *by New Zealanders* (see for example the New Zealand Official Yearbook 1997, pp. 408-409). Note the words "by New Zealanders". That means the more income that goes to overseas investors, the smaller "Savings" appear to be in the National Accounts. Since net foreign investment income is the largest influence on our current account deficit, the bigger our current account deficit, the smaller "Savings" appear to be. It is termed a "residual" item: it is not calculated from surveys or other data in its own right. It is simply what is left over when final expenditure on consumption is deducted from "national disposable income", and includes the large statistical discrepancies that always occur in these data. So *by definition* national "Savings" appear worse when interest and dividends are flowing out at their current enormous rate. It's not that you and I have (as Peters and Shipley imply) been wastrels. It is that overseas investors are exporting our national "Savings".

The real question is why "free market" investment has failed

New Zealanders are in fact good savers, as surveys by Westpac and FPG Research have shown (for example *Press*, "Big increase in personal savings", by Alan Williams, 15/9/97, p.25). What *is* important about savings, as far as the Balance of Payments is concerned, is what happens to them: how those savings are *invested* in assets to increase future income. In particular, how those savings are invested to reduce overseas ownership of our assets, and to produce more exports.

Savings does not automatically equal investment. A considerable part of savings are used by banks to lend to credit card users, for example – and household debt is increasing faster than savings.

A large part of household savings goes into housing – more than many other countries. Households here in Aotearoa have $15 in financial assets (shares, bonds, long-term bank deposits) to every $42 in fixed assets (principally houses) whereas in the U.S. the ratio is 40:20, and the U.K. 39:28 (*Listener*, "Hard up", by Selwyn Parker, 30/5/98, p.57). But that is only part of the picture.

The hard question for the advocates of the free market, is why "the market" has not responded to the huge changes of the last 15 years to produce an internationally competitive economy. This is in spite of international competitiveness being an explicit and fundamental objective of the radical changes. As Brian Gaynor has pointed out (*New Zealand Herald*, "Roundtable wedded to rigidity", 13/3/98, p.E2) investment is not going into the export sector: "New Zealand's exports grew by only 78% in the 1984-1997 period compared with 160% for Australia and 137% for the OECD average. Ireland, which has had little economic reform and no major asset sales, had export volume growth of 260% over the same period. ... The export sector has not been able to attract its fair share of the investment dollar." Thus our exports are not growing fast enough to pay for the runaway increase in payments to foreign investors. Neither are our import-competing industries able to compete sufficiently to reduce the demand for imports.

Too much investment is going into schemes designed for capital-gain – notably existing property – rather than production. The rapid increase in foreign ownership of the economy in general also indicates a failure of the market to attract investment from within Aotearoa. Having dismantled the single largest domestic source of investment – the government and its state-owned enterprises – the new regime has been able to replace it only by incurring enormous and unsustainable debt.

Instead of focussing on savings, the government should be asking itself about why its policies have failed to encourage new investment in the right places, and why "the market" has failed to balance our accounts with the rest of the world in a sustainable fashion.

Crisis number two: Asia

So much has been written about the crisis in East Asia and the former Soviet Union that it is unnecessary to describe the events here in detail. A few aspects are important to emphasise.

Human calamity

First is the enormity of the crisis – barely portrayed in our media, which focus on the financial markets which caused the crisis. In January for example, Reuters reported that "a huge majority of Indonesia's listed companies are ... technically bankrupt unless the rupiah stages a dramatic rebound" (*Press*, "Most firms bankrupt", 10/1/98, p.21). That meant massive unemployment and wage cuts. The plummeting currencies caused enormous price increases and food shortages for the countries' people, many of them already impoverished. Indonesia was hardest hit in this way (its currency fell by 71% between July 1997 and January 1998 alone), leading to bloody riots, murderous scapegoating of the Chinese community, and intense social disruption as city dwellers were forced by their loss of income or jobs to return to their villages.

In Korea an election was hijacked by the IMF, forcing the yet-to-be elected President to accede to its demands for radical policy changes at a few hours notice or be held up as bearing responsibility for the crisis. The changes have led to massive strikes throughout the country as wage cuts and redundancies sweep through Korea's industry.

In Russia, the crisis has added further desperation to the chaotic scene of a disintegrating society reminiscent of pre-Nazi Germany. In the former Soviet Union as a whole, industrial output has plummeted by 48.8% and GDP by 44.0% over the 1989-95 period (UN Commission for Europe, quoted by Michel Chossudovsky in "The Global Financial Crisis", October 1997). That means rampant poverty, unemployment, insecurity and crime.

Hundreds of millions of people in Asia are being punished by this crisis for economic crimes they did not commit. The crisis has been compared to the 1929 crash, and its ultimate effects have certainly not been seen yet.

A failure of orthodox economic theory

Second is the startling failure of economic orthodoxy. That failure is demonstrated both before and after the crisis. It is hard not to remember the mantra repeated everywhere of the "Asian Miracle". Here, we were told, were *the* shining examples of how open, free-market, deregulated economies (never mind the social costs) would lead to rapid growth and economic success.

Now, we are told, those economies were not really that free. They are run by corrupt governments and "crony capitalism". Of course they are – but if that was part of the economic model, we were never told about it before. On the contrary, those pointing out the murderous and corrupt nature of the Indonesian kleptocracy were ignored in the interests of trade and economic relations. Facing up to the implications of corrupt government includes asking whether the people of these countries would have chosen this form of economic development had the choice been available.

True believers are now looking at South America for the next batch of ideal economies (no corruption or crony capitalism there, surely!). The real question is: *is* there an example of a successful "true" free-market open economy that everyone can emulate?

If the free market is not the answer, the IMF has no other. It is busy "rescuing" these countries by prescribing even more radical free-market policies. Having prescribed fixed exchange rates to encourage foreign investors in the past, it now enforces a universal model of floating exchange rates. It is forcing deregulation, an end to subsidies on essential foods and other goods, and taking protection from industry. It insists on the economies being opened to foreign investment and takeover. If corruption, dictatorship and cronyism were problems, their removal is not part of its prescribed solution.

Such economic policies are recognised by many as having brought about the crisis in the first place. Rarely has the IMF been so widely criticised for such policies by mainstream economists and politicians. For example, Martin Feldstein, Professor of Economics at Harvard University and President of the U.S. National Bureau of Economic Research, writing in the journal *Foreign Affairs* ("Refocusing the IMF", March/April 1998, pp.20-33) wrote

> "The IMF's recent emphasis on imposing major structural and institutional reforms as opposed to focusing on balance-of-payments adjustments will have adverse consequences on both the short term and the more distant future. The IMF should stick

> to its traditional task of helping countries cope with temporary shortages of foreign exchange and with more sustained trade deficits."

Even Harvard economist, Jeffrey Sachs, an architect (on behalf of the U.S. government) of the current economic disaster in Russia and past adviser to the U.S. government on economic "development" in other countries, is admitting

> "The situation is out of hand. However useful the IMF may be to the world community, it defies logic to believe that the small group of 1,000 economists on 19th Street in Washington should dictate the economic conditions of life to 75 developing countries with around 1.4bn people.
>
> "These people constitute 57 per cent of the developing world outside China and India (which are not under IMF programmes). Since perhaps half of the IMF's professional time is devoted to these countries – with the rest tied up in surveillance of advanced countries, management, research, and other tasks – about 500 staff cover the 75 countries. That is an average of about seven economists per country.
>
> "One might suspect that seven staffers would not be enough to get a very sophisticated view of what is happening. That suspicion would be right. The IMF threw together a draconian programme for Korea in just a few days, without deep knowledge of the country's financial system and without any subtlety as to how to approach the problems.
>
> "Consider what the Fund said about Korea just three months ago in its 1997 annual report. 'Directors welcomed Korea's continued impressive macroeconomic performance [and] praised the authorities for their enviable fiscal record.' Three months ago there was not a hint of alarm, only a call for further financial sector reform – incidentally without mentioning the chaebol (conglomerates), or the issue of foreign ownership of banks, or banking supervision that now figure so prominently in the IMF's Korea programme.
>
> "In the same report, the IMF had this to say about Thailand, at that moment on the edge of the financial abyss. 'Directors strongly praised Thailand's remarkable economic performance and the authorities' consistent record of sound macroeconomic policies.'"
> (*Financial Times*, "IMF is a power unto itself", 11/12/97)

Perhaps most damning – and most interesting – is Joseph Stiglitz, the World Bank's chief economist and senior vice president, who in a UN sponsored address in Helsinki in January called for an end to the "Washington Consensus" which drives the World Bank and the IMF. Recognising that many of the successes of the East Asian nations were due to their governments' interventions (their deviations from the free market) he says that "Washington Consensus" policies are

> "not complete, and they are sometimes misguided. Making markets work requires more than just low inflation; it requires sound financial regulation, competition policy, and policies to facilitate the transfer of technology and to encourage transparency, to cite some fundamental issues neglected by the Washington consensus. Our understanding of the instruments needed to promote well-functioning markets has also improved, and we have broadened the objectives of development to include other goals, such as sustainable development, egalitarian development, and democratic development.
>
> "... I shall argue that the messages of the Washington consensus in the two core areas are at best incomplete and at worse misguided. While macro-stability is important, for example, inflation is not always its most essential component. Trade liberalisation and privatisation are key parts of sound macro-economic policies, but they are not ends in themselves. They are means to the end of a less distorted, more competitive, more efficient marketplace and must be complemented by effective regulation and competition policies.
>
> "... all too often the dogma of liberalisation became an end in itself, not a means of achieving a better financial system."

("More Instruments and Broader Goals: Moving Toward the Post-Washington Consensus", Helsinki, Finland, 7/1/98. See http://www.wider.unu.edu/stiglitx.htm.)

Lessons for Aotearoa

Which brings us to the third aspect of the Asian crisis: lessons for Aotearoa. The similarities to our current financial position are sobering.

The immediate cause was the huge reliance on foreign investment by the worst affected East Asian countries, according to Filipino academic, Walden Bello, who over a period of years has pointed out these structural problems and their likely consequences (the following data comes from "Addicted to Capital: the ten year high and present day withdrawal trauma of Southeast Asia's economies", by Bello, in *Focus on Trade*, Number 20, November 1997). Escalating current account deficits triggered the crisis. In Indonesia, private foreign debt (US$55.5 billion) was at 25% of GDP in 1997, two-thirds of which was due within a year, and a current account deficit which had risen from US$2.9 billion in 1994 to US$7.2 billion (about 3% of GDP) in 1995.

In the Philippines, the current account deficit was estimated to be around 7% of GNP in 1996, having doubled in three years. Its private foreign debt was about 13% of GNP in 1996, and total foreign debt about 40% of GNP.

In Thailand, where the house of cards began its fall, foreign debt was US$89 billion (about 20% of GDP) in 1996, almost 80% of which was private debt and a little under half of which was short-term debt. The current account deficit was mounting after zero growth in exports in 1996 due to investment going into property rather than export industries.

In all these countries, high interest rates were encouraging overseas borrowing and investment in non-productive sectors such as property. All based their development strategies on IMF and World Bank recommendations to welcome foreign investment and allow the free flow of capital and investment income. Similarly, all were steadily dismantling any protection of their domestic economies under WTO and IMF pressure. The pictures in Korea, Japan, China and Russia are different again. China for example, the only non-market economy, has so far managed to remain clear of the crisis and its recent experience was described by Stiglitz in his Helsinki speech as "one of the greatest economic success stories in history".

As was seen above, New Zealand's debt and current account deficit are both well above the levels that led to crisis and collapse in Southeast Asia. Rates of interest are amongst the highest in the OECD, and insufficient investment is going into exports or into import substitution. On the other hand (a fact relied on by local economists to defend policies they have long advocated) our financial sector does not have the high bad debt levels that foreign investors also find threatening. We should not feel comfortable. Those who do not learn from history are doomed to repeat it.

Unsurprisingly, these events have led to questions about the wisdom of relying on foreign investment. Even Jagdish Bhagwati, one of the foremost authorities on trade, advocate of free trade, and adviser to the Director-General of the GATT from 1991-1993, has written of "The Capital Myth: The Difference between Trade in Widgets and Dollars" (*Foreign Affairs*, May/June 1998). Focusing on short-term, highly mobile, portfolio investment, he draws a sharp distinction between the theories favouring free trade and "the fog of implausible assertions that surrounds the case for free capital mobility."

Then why, he asks, has the world been moving in this direction? "The answer, as always, reflects ideology and interests – that is, lobbies. … Wall Street's financial firms have obvious self-interest in a world of free capital mobility since it only enlarges the arena in which to make money." Economic rationalism is clearly rational only for these vested interests. He concludes:

> "And despite the evidence of the inherent risks of free capital flows, the Wall Street-Treasury complex is currently proceeding on the self-serving assumption that the ideal world is indeed one of free capital flows, with the IMF and its bailouts at the apex in a role that guarantees its survival and enhances its status. But the weight of evidence and the force of logic point in the opposite direction, towards restraint on capital flows. It is time to shift the burden of proof from those who oppose to those who favour liberated capital."

The New Zealand Government, Mike Moore, and all advocates of the MAI take note. Foreign investment is a powerful drug which can benefit in small doses, but leads to destruction if not controlled.

The immediate effects on Aotearoa of the Asian crisis have been a sharp drop in our dollar and a fall in exports to and tourism from the countries directly affected. The movements of the New Zealand dollar have shown once again how little our currency reflects the state of our economy: it is driven at times by interest rates attracting foreign investors, at time of writing (July) by some imagined link to the Japanese yen, at yet other times by those financial firms' views of political risk (read: risk to their pockets), rarely by our balance of trade, and almost never by the needs of our economy.

So what are the lessons for Aotearoa of these coinciding, mutually reinforcing crises? Economist Brian Easton in his *Listener* column (4/7/98, p.57) quoted Stiglitz again:

> "Small, open economies are like rowing boats on an open sea. One cannot predict when they might capsize; bad steering increases the chances of disaster and a leaky boat makes it inevitable. But their chances of being broadsided by a wave are significant, no matter how well they are steered and no matter how seaworthy they are."

Which raises the question why anyone would be stupid enough to put to sea in a rowing boat: why live the terrifying life of an open economy?

But we are not that helpless. A more positive analogy would be of a coastal town. Left without protection, the town will periodically be wrecked by storms from the sea. In better weather, its people will make proper preparations for going to sea, to reap the benefits it can bestow.

We are foolish to design an economy that must go to sea in all weathers: it must have a sound domestic base. It must not hesitate to protect itself against the storms of capital mobility and ruthless or monopolistic trading and investing corporations. It must make best use of all the tools available, including government regulation, and where appropriate, ownership of resources. It cannot rely on the weather of the market to simultaneously balance its foreign earnings and payments, and ensure an improving and secure standard of living for its people.

July 1998