Alan - Presentation

Alan Shipman:
I'm Alan Shipman. I'm a Lecturer in Economics. One of the most exciting moments in Social Science comes when you find that one thing leads to another but it doesn't go the way that you expect it.

Sometimes the first thing and the second thing are associated but you find that actually they're both caused by a third thing that you haven't studied before. Or you find that what was apparently the cause isn't actually the effect. For example, I'm using notes for this talk because I think my memory's bad but it could well be that my memory's bad because I use notes too much.

Economists thought for a long time that savings turn automatically in to investment. If you and I don't immediately spend all our income then there's a bit of a national income that's going spare and a bit of national output that's also going spare. Businesses can then use that unspent income to invest in projects that generate more income in the future and that makes us richer. Investment finance by saving will turn our present sacrifice of consumption in to more consumption in the future. And that rather neatly matches the story we like to tell our children which is that if you save up and put things aside then you're going to be better off than the people who guzzle everything now. Splurging all your pocket money on sweets is going to make you sick whereas if you don't do that you'll be slightly hungry today and running a multi billion dollar business tomorrow.

Another part of this conventional story is that banks are financial intermediaries. They just channel our savings in to business investment. They just connect borrowers and savers the way that Crowdfunding seems to be doing now. Well it's true that saving and investment are closely linked. In fact according to National Income Accounting they have to be identical.

Household saving doesn't always equal business investment but if we take the economy as a whole the total saving has to equal the total investment once we've taken account of the government's budget and the international sector as well.

But after some rethinking that economists had to do after big down turns in the 19th and 20th centuries we've realised that actually the link between saving and investment goes the other way. It's the investment that determines the saving. If businesses invest more national income goes up and households have got more money and they can save more of it. Whereas if households try to save more there's less demand and businesses invest less, the national income goes down and there's actually less household income to save out of. So households can't save more unless businesses are wiling to invest more.

That does raise a question. How can businesses invest money that hasn't first of all been saved? Another economist's great discovery is that banks aren't just financial intermediaries, Lloyds, RBS, Barclays, they wouldn't be such a big presence on the High Street if they just waited for us to deposit money before they lend money out to businesses. Most of the loans that those banks make are actually not backed by deposits, that's new money that goes in to the borrowers accounts doesn't seem to have come from anywhere.

For the world as a whole investment has got to be matched by saving but in a world of big cross border flows of production and consumption and capital individual countries can invest more than they save and individual governments can spend more than they raise in tax just as long as other countries are willing to finance that with an outflow of their own saving.

That's why a number of countries including the United States and the United Kingdom have actually been able to grow consistently and get much richer while saving very little. They were able to invest other people's money as well as their own. The other side of that coin as it rolls across those national borders is that some countries saved a lot but grew very slowly. They let some of the funds go to waste or they let other countries invest some of those resources in effect helping other people get richer.

Ideas about governments and their budgets have also changed and even gone full circle. It used to be thought that if governments borrow then households and businesses are going to have to save in order to pay their future tax bills. And so the economy is not going to get any sort of boost. Now some economists argue that it's because households and businesses save the governments have to borrow and if they don't the economy could be heading for recession. That's an idea we have to take account of in an age when governments are inflicting a lot of austerity on people in order to bring their borrowing down.

At least one of the old certainties has survived until recently. It still seems that economic growth depends on investment. Countries might not need to save in order to invest but they still have to invest a lot in order to grow their output and raise their income. More output needs more capital and you only get more capital if you invest in new tools, new skills, new technologies faster than the old ones are wearing out.

But after research even that part of the picture is a lot less clear. Some countries, especially the richer ones, seem able to grow very fast while investing very little. Others, especially some poorer ones, invest a lot and don't seem to grow. There are some kinds of investment that don't add a lot to production and consumption capacity and some investments might even make it shrink.

What really determines a country's income in consumption opportunities is the amount of capital that they command. That's capital in the wider sense, human skills,

technologies, natural resources, Intellectual Property as well as production plants and equipment. But the capital a country commands doesn't all have to be located inside it. Countries like the United States and the United Kingdom control a lot of capital beyond their borders through stock market investments and the activities of their multi national companies.

And although we traditionally think of investment being expenditure that adds to capital that's a very loose association. A lot more production can be generated from the present capital just by using it more efficiently without expanding it. A lot of investment doesn't add to capital, it may even be capital saving allowing us to generate more production from a smaller stock. And sometimes it's growth and the capital stock that generates the investment rather than the other way round.

I've talked a lot about economics but these reversals of ideas about causation which change our view of the world and what to do with it are part of the excitement of learning and researching across the Natural and Social Sciences.

There used to be a consensus among nutritionists that if we ate too much we'd put on weight. Now it's being seriously proposed that we got that the wrong way round. It's actually that we put on weight and that makes us eat more. The bigger the physiology we have to support the more calories we need to support it. That's a similar realisation about human growth to the one that I've been describing about economic growth. If high investment is associated with a larger capital stock it may just be that having lots of capital requires more investment to keep it repaired and maintained. And not the case that virtuous high investment causes the capital stock to grow large.

Find a close association and reverse the conventional ideas about causation. That's not all that science is about but a lot of big advances have happened this way and it's a useful safeguard against getting some fundamental things the wrong way round.