The Global Savings Tsunamis

The global economic crisis has some surprising causes, but who would have guessed that overzealous saving was one of them?

BY ROBERT Z. ALIBER

Renowned economist John Maynard Keynes explained the crisis of the Great Depression in terms of the "paradox of thrift": Individual saving is a private virtue, but when many individuals rapidly increase their savings at the same time, the demand for goods and services will drop and the unemployment rate will rise. In the last 30 years, as national financial markets have become increasingly integrated, some countries with exceptionally high savings rates—Singapore, Japan, China—have made an end run around Keynes's paradox and exported some of their excess savings to their trading partners, in particular, the United States.

The huge global pool of savings that has accumulated in this way over the last few decades, now amounting to trillions of dollars, has been the source of four successive tsunamis that have first uplifted, then flattened, some of the world's leading economies. The first tsunami struck Mexico, Brazil, and other developing countries in the 1970s; the second hit Japan and three Nordic countries in the late 1980s; another swamped Thailand, Malaysia, Russia, and eventually Argentina in the mid-1990s. We are now living in the aftermath of the fourth tsunami.

The pattern has been similar each time. The tsunami brings a deluge of money into a country, causing its currency to appreciate and prices of real estate and of stocks to rise. Its economy booms. Rational exuberance morphs into irrational exuberance—a bubble develops. But eventually the inflows decline and the national currency often crashes, with disastrous consequences. The party ends abruptly and painfully. In the Asian financial crisis of the late 1990s, stock market indexes plunged throughout the region and unemployment in Indonesia, the Philippines, South Korea, and Thailand soared. On Wall Street and in other global finance centers, banks and other big institutions trembled, and some collapsed. The crisis in Russia in 1998, for example, delivered the coup de grâce to the U.S. hedge fund Long-Term Capital Management.

The tsunamis are an indirect consequence of a dramatic change in international money flows that began around 1980. Until then, the United States had been far and away the world's largest creditor and source of investment money. American savings began to flow abroad during World War I, initially when the United States helped the British and French finance their war efforts, and then in the 1920s as more dollars poured into private investments and government bonds. By the early 1940s, the United States was the world's largest foreign investor. By 1980, its net for-

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But the next 20 years brought a reversal of unprecedented proportions. By 2000, America's net foreign liabilities had become larger than those of all other debtor countries combined, and its liabilities were still growing rapidly as foreign savings surged into Treasury bills and other dollar-denominated securities. The shift was amazingly rapid. Britain was the world's largest net creditor before the United States took its place nearly 100 years ago, and despite the extraordinary costs of two world wars, the island nation remained an international creditor until just a few years ago.

The change in America's international investment position did not occur because the U.S. Treasury or major American corporations borrowed money in yen or yuan. Foreign savings "crowded in" to the United States, and the U.S. economy adjusted to accommodate the inflow: Interest rates fell, so Americans saved less and consumed more.

In the 1980s and '90s, more of these savings came from Japan than from any other country. As its economy matured and its growth slowed after the post–World War II recovery, Japan's domestic investment declined, and the excess savings flowed abroad. The Japanese invested most of that money in dollar securities, where it would be safe and liquid. Other Asian countries—Taiwan, South Korea, Singapore, Thailand, and most recently China—have followed the same path. As of April, China held $764 billion in U.S. Treasury securities—more than any other country—and many billions more in other dollar investments.

This is not the first time that excess domestic savings have entered the international economy. Countries that grow rapidly almost always generate extra cash as their economies mature and their domestic investment declines—it is as if it takes time for households to realize their good fortune and increase their consumption. In the 17th century, the Dutch generated enormous savings to finance the draining and development of their lowlands, and as that

work was completed they continued to save at high levels and began to invest overseas. They were succeeded as the major exporter of savings by the British in the 19th century and the Americans in the 20th.

Two factors distinguish the savings tsunamis of the past 35 years from earlier experiences. One is that the volume of savings in various Asian countries has been extraordinary—as high as 40 or 50 percent of their gross domestic products. This Herculean thrift is not only the product of personal virtue. A variety of government policies, from low interest rates to mandatory savings laws, keep ordinary people as well as corporations socking large quantities of money away.

The second crucial difference lies in how the savings have been invested. In the past, the United States and other creditors acquired longer-term overseas investments, such as foreign companies, stocks, and bonds. But Japan and other creditor countries today keep a very high proportion of their foreign holdings in short-term assets (securities that are essentially liquid or, at most, mature in a few months' time), such as Treasury bills and bank deposits—potential "hot money" that can be moved quickly to anywhere in the world.

The big international banks that take short-term dollar deposits from the Bank of Japan, the People's Bank of China, and other central banks are always seeking profitable ways to invest this money. And in many countries where they do business, they can often make loans at interest rates significantly below those offered by their domestic banks. In the 1970s, when the deposits came from Saudi Arabia and other oil exporters, the banks engaged in "petrodollar recycling"—lending generously to governments and government-owned firms in Mexico, Brazil, Argentina, Chile, and other developing countries. Amid surging commodity prices for their products, the Latin American economies were booming, the demand for new roads, bridges, and other infrastructure was high, and it seemed the good times would never end. "Countries don't go bankrupt," one of the world's leading bankers declared. The Latin American debt crisis, which was triggered by the Mexican government's default in the middle of 1982 and resulted in years of economic and political pain throughout the region, proved him wrong, but the lesson never seems to sink in.

Recently, China has begun to question the dollar's role as the world's dominant reserve currency. But no one obliged China to buy hundreds of billions of dollars of U.S. Treasury bills and bonds. Its central bank could have bought securities denominated in the Albanian lek or the Zambian kwacha. Beijing buys dollars primarily because the low value of the yuan enables the Chinese to sell vast quantities of goods to the United States. China's leaders depend on exports to create the tens of millions of manufacturing jobs in Shenzhen, Guangzhou, and Xiamen they need to keep the social peace.

It would be a great boon to American manufacturing firms if China were to end its currency protectionism. The yuan would appreciate sharply, reducing China's exports. America's trade deficit would shrink. But Beijing is not likely to let market forces determine the value of its currency. And if it were to begin buying many more yen or euros instead of dollars, as it sometimes suggests it will, politicians from Tokyo to Paris would go ballistic. They would accuse the Chinese of following a classic "beggar-thy-neighbor" policy, keeping the value of the yuan artificially low and thus increasing China's exports to their countries. So China's leaders will continue to buy dollars, even as they complain loudly that the United States' trade and fiscal deficits are too large.

Over the next few years, the global savings glut will become even larger. Sluggish economic growth around the world will expand the pool of global savings, and most of the money will be used to buy dollar-denominated securities, for the simple reason that they remain the most attractive investment. That means that governments in the United States and Europe are likely to find it relatively easy to finance the enormous fiscal deficits that lie before them. It also means that inflation rates in these countries are likely to remain low.

But another, less comforting implication of continued growth in global savings is that more money will flow to countries outside the United States and Europe. Some will see their currencies appreciate, and before long they will experience "irrational exuberance." Then will come the collapse—a shock both to these countries and to the global economic system. We have seen the pattern before. The question is, where will the next tsunami strike: India? Brazil? South Korea? ■