Is Global Economic Stability or Instability Still Possible ?

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Abstract

In the era of globalization, the export-import of savings and investments has also been globalized. The saving-investment gap or excess saving over investment has a dual role in creating internal and external economic instability. While, for example, positive excess saving over investment creates an internal economic recession, on the other hand, it creates favorable balance of current account. Paradox of thrift (or the effects of excess savings over investment) is equally applicable to both the national economy and global economy. Owing to saving-investment inequality both at the national and global level, the achievement of the optimal level of internal and/or external economic status of all the countries is not possible simultaneously in the globalized world.

Keywords : saving, investment, internal, external, balance

On the basis of certain assumptions and conceptions, this article attempts to answer the only question: Is the achievement of the optimal level of internal and/or external economic status of all countries still possible simultaneously in the globalized world ?

Assumptions and Conceptions

(1) Foreign trade is run by the foreign exchange rate, which is the rate at which one currency is exchanged for another currency. It is the relative price of one currency in terms of another currency. If India trades with USA, India's foreign exchange rate is given by the relative price of the U.S. dollar in terms of Indian rupee, that is, the ratio of Indian rupee to U.S. dollar (or Indian rupee/U.S. dollar).

(2) Foreign exchange rate is determined by the demand for and supply of foreign exchange/currency (say, U.S. dollar). The variability of foreign exchange rate depends on the relative strength of demand for and supply of foreign exchange/currency. Given the supply of foreign exchange, an increase (or a decrease) in the demand for foreign exchange leads to an increase (or a decrease) in the foreign exchange rate. Similarly, given the demand for foreign exchange, a decrease (or an increase) in the supply of foreign exchange leads to an increase (or a decrease) in the foreign exchange rate. An increase in the foreign exchange rate (say, Indian rupee/U.S. dollar) implies the depreciation of Indian currency and the appreciation of American currency. On the other hand, a decrease in the foreign exchange rate (say, Indian rupee/U.S. dollar) implies the appreciation of Indian currency and the depreciation of American currency.

(3) Depreciation and devaluation are not synonymous, though both have the same or similar effects. While

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devaluation of a currency is brought about by the deliberate, discretionary, and decisionized action of a national government, the depreciation of a currency occurs by the interaction of the demand for foreign exchange and the supply of foreign exchange in the foreign exchange market. For example, an increase in India's demand for foreign exchange (say, U.S. dollar) in the foreign exchange market, *ceteris paribus*, leads to an increase in the relative price of foreign currency (Indian rupee/U.S. dollar), which implies the depreciation of Indian currency (Indian rupee) and the appreciation of foreign currency (U.S. dollar). On the other hand, if 1 $ = ₹ 40 in 2000 and if the Indian government, under the *ceteris paribus* assumption, decides to arrive at 1 $ = ₹ 60, such governmental action is termed as devaluation of the Indian currency. However, both devaluation and depreciation encourage export and discourage import, and thereby, increase the volume of foreign exchange reserve as well as reduce or rule out the deficit in the balance of payment (BOP). The negative effect of devaluation or depreciation is that the prices of importable goods and services increase, and as a result, inflation accelerates. Devaluation or depreciation increase/encourage a country's internal imbalance. Thus, by means of devaluation or depreciation, external imbalance can be reduced or ruled out at the cost of internal imbalance of a country.

(4) The vital indicators of internal imbalance are wage-price flexibility (e.g. inflation, deflation, and stagflation), stagnation (e.g. increase in unemployment and decline in income), and increase in inequality of income and wealth.

(5) The external imbalance can be indicated by the fluctuation of foreign exchange rate, disequilibrium in BOP, increase in domestic indebtedness to foreign countries, and depletion of foreign exchange reserves.

(6) $BOP = (BOCUA + BOCAA)$, where $BOCUA \equiv$ balance of current account, and $BOCAA \equiv$ balance of capital account, where the symbol "$\equiv$" means "stands for".

(7) *BOCUA* need not always balance, but can show a surplus or deficit, which can be settled by a transaction on the *BOCAA*. Whatever the value of *BOCUA* is, there will always be a residual transaction (e.g. capital transaction in the name of borrowing from abroad and selling assets to foreigners), which can bring the *BOP* into equilibrium/balance in the accounting sense.

(8) *BOP* is always in balance/equilibrium in the accounting sense or double-entry book-keeping sense.

(9) Trading countries can be classified into three groups on the basis of the nature of the relationship between "national saving" (*S*) and "national investment" (*I*), as follows:

(i) Group of countries with "positive excess saving over investment," which means that $S > I$ or $(S-I) > 0$.

(ii) Group of countries with "negative excess saving over investment," which means that $S < I$ or $(S-I) < 0$.

(iii) Group of countries with "zero excess saving over investment," which means that $S = I$ or $(S-I) = 0$, where $S \equiv$ National saving = [Private saving + Government saving] and $I \equiv$ National Investment = [Private investment + Government investment].

In the globalized world, the positive excess saving of a group of countries can be exported to the rest of the world (or the residual group of countries) with negative excess saving over investment, because the positive excess saving over investment of a group of countries is equal to the negative excess saving over investment of the rest of the world. Symbolically, $\sum^{m}(S-I) = -\sum^{n}(S-I)$, where $(m + n)$ = Total number of trading countries in the world.

(10) Keynes (1936) and Keynesians emphasize that the status of the internal balance of the capitalist countries is determined by the nature of the relationship between National Saving (*S*) and National Investment (*I*), as follows:

(i) $S > I$ or $(S-I) > 0 \Rightarrow$ an economic depression, recession, or crisis.

(ii) $S < I$ or $(S-I) < 0 \Rightarrow$ an economic expansion or boom.

(iii) $S = I$ or $(S-I) = 0 \Rightarrow$ neither economic depression nor economic expansion, which means the stability of the "internal balance," where the symbol "$\Rightarrow$" stands for "implies".

In the globalized world, the expansionary effects in a group of countries occur at the cost of the contractionary effects in the rest of the world.

(11) From the relevant literatures (e.g. Corden, 2011a, 2011b ; Duncan, 2012; Feldstein, 1992; Olivei, 2000), we can get the five definitional equations of *BOCUA* as follows:

(i) $BOCUA_t = [B_t - B_{t-1}]$, where $t \equiv$ time period t, $B_t \equiv$ country's net international investment.

(ii) $BOCUA_t = [(X_t - M_t) + r_t B_t]$, where $X_t \equiv$ export, $M_t \equiv$ import, $r_t \equiv$ rate of interest and $rB_t \equiv$ net (investment) income from abroad.

(iii) $BOCUA_t = [Y_t - A_t] = [Y_t - E_t]$, where $Y_t \equiv$ GDP, $A_t \equiv$ aggregate absorption $= E_t \equiv$ aggregate expenditure $= [C_t + I_t + G_t]$, where $C_t \equiv$ private consumption, $I_t \equiv$ private investment, $G_t \equiv$ government expenditure $= [$Government consumption expenditure $(G_{Ct}) +$ Government investment expenditure $(G_{It})]$

(iv) $BOCUA_t = [S_t - I_t]$, where $S_t \equiv$ national saving and $I_t \equiv$ national investment.

(v) $BOCUA_t = [(S_t + F_t) - I_t]$, where $F_t \equiv$ amount of national paper money printing or fiat money creation.

Results and Discussion

The nature/status of the "external balance" of a country can be explained in terms of the foregoing five equations 11(i) - 11(v) as follows:

(1) From equation 11(i), we get the following results:

(i) $BOCUA_t = [B_t - B_{t-1}] < 0 \Rightarrow$ Deficit in *BOCUA*
(ii) $BOCUA_t = [B_t - B_{t-1}] > 0 \Rightarrow$ Surplus in *BOCUA*
(iii) $BOCUA_t = [B_t - B_{t-1}] = 0 \Rightarrow$ Equilibrium in *BOCUA*

(2) From equation 11(ii), we get the following results :

(i) $BOCUA_t = [(X_t - M_t) + r_t B_t] < 0 \Rightarrow$ Deficit in *BOCUA*
(ii) $BOCUA_t = [(X_t - M_t) + r_t B_t] > 0 \Rightarrow$ Surplus in *BOCUA*
(iii) $BOCUA_t = [(X_t - M_t) + r_t B_t] = 0 \Rightarrow$ Equilibrium in *BOCUA*

(3) From equation 11(iii), we get the following results:

(i) $BOCUA_t = [Y_t - A_t] = [Y_t - E_t] < 0 \Rightarrow$ Deficit in $BOCUA$

(ii) $BOCUA_t = [Y_t - A_t] = [Y_t - E_t] > 0 \Rightarrow$ Surplus in $BOCUA$

(iii) $BOCUA_t = [Y_t - A_t] = [Y_t - E_t] = 0 \Rightarrow$ Equilibrium in $BOCUA$

(4) From equation 11(iv), we get the following results:

(i) $BOCUA_t = [S_t - I_t] < 0 \Rightarrow$ Deficit in $BOCUA$

(ii) $BOCUA_t = [S_t - I_t] > 0 \Rightarrow$ Surplus in $BOCUA$

(iii) $BOCUA_t = [S_t - I_t] < 0 \Rightarrow$ Equilibrium in $BOCUA$

(5) From equation 11(v), we get the following results:

(i) $BOCUA_t = [(S_t + F_t) - I_t] < 0 \Rightarrow$ Deficit in $BOCUA$

(ii) $BOCUA_t = [(S_t + F_t) - I_t] > 0 \Rightarrow$ Surplus in $BOCUA$

(iii) $BOCUA_t = [(S_t + F_t) - I_t] < 0 \Rightarrow$ Equilibrium in $BOCUA$

The "paradox" is that what is true for an individual of a country may not be true for that country itself. Similarly, what is true for a country of the world may not be true for the world itself. In better words, what is positive or negative at the micro level may be negative or positive at the macro level and global level.

Keynes's (1936) 'national paradox of thrift' is an appropriate, adequate, or apposite example of such paradox. The national paradox of thrift implies that if an individual of a country tries to save more (or consume/spend less), his/her actual savings increase, and as a result, he/she becomes richer or wealthier. But if all the individuals of a country try to save more (or consume/spend less), the actual saving and income of that country inevitably falls. In other words, an attempt to save more (or consume/spend less) by a country as a whole is self-defeating. Still, in other words, the more a country tries to save (or consume/spend less), the more its income and investment fall, and as a consequence, the less there is available to save. The national paradox of thrift can symbolically be represented by the inequality : $[S - I] > 0$, or $S > I$. The national paradox of thrift cannot hold or operate, if either (i) $[S - I] = 0$ or $S = I$, or (ii) $[S - I] < 0$ or $S < I$.

The tradeoff between the internal balance and the external balance of a country can be disclosed in terms of the relationship between national savings and national investment. The status of the internal balance of a country has been explained by the point (10), while the status of the external balance of a country has been explained by points (4) and (5) of this section.

From the points (10) of the previous section and point (4) of this section, we get the following results:

(i) Deficit in $BOCUA$ is associated with internal economic expansion.

(ii) Surplus in $BOCUA$ is associated with internal economic contraction.

(iii) Equilibrium in $BOCUA$ is associated with internal economic balance.

Keynes's (1936) 'national paradox of thrift' is equally applicable to the world economy. The 'world paradox of thrift' states that the world cannot spend less (or save more) than it earns, because the expenditure of a group of countries (say, country group-A) is the income of the remaining group of countries (say, country group-B). So, if the whole world (consisting of country group-A and country group-B) tries to spend less (or save more) than it earns, the result is that it does not increase world saving, but simply reduces world income, investment, and

employment. Thus, the validity of the 'world paradox of thrift' creates world crisis, depression, or stagnation.

Hence, in order to vitiate/violate the world paradox of thrift, some countries should/can spend less than they earn, if the remaining countries do the opposite, that is, if they spend more than they earn. The non-operation of the world paradox of thrift indicates that the increase in austerity of a group of countries can bring about the increase in adversity of the remaining group of countries in the world. Thus, the internal or external balance of some countries can be achieved at the cost of internal or external imbalance of the remaining countries. This means that the world internal or external balance or imbalance cannot be realized at a given point of time or period of time. In other words, all the countries of the world cannot achieve their internal or external balances or imbalances simultaneously at a given point of time or period of time.

Some 'positive excess saving over investment' countries, which are called saving-glut countries (e.g. China, Japan, German, Korea, Taiwan, and OPEC), coined on April 14, 2005 by Ben Bernanke, the Chairman of the U.S. Federal Reserve, enjoy surplus in *BOCUA*. That is why they are keen on lending to or investing in the negative excess saving over investment countries, which are called the saving-deficient countries (e.g. USA, UK, France, Brazil, Pakistan, Sri Lanka, South Africa, and India). According to Duncan (2012), most of the money lent to or invested in the saving-deficient countries by the saving-glut countries is not derived from their national savings, but by the newly created fiat money or newly printed paper money.

Thus, from equation of section two, point 11(v), we get a 'new version' of $BOCUA_t = [(S_t + F_t) - I_t]$, instead of a preexisting version of $BOCUA_t = [S_t - I_t]$ given by equation 11(iv) in the previous section. Hence, saving-glut countries should/can be substituted with or transformed into paper money printing-glut countries. The newly printed paper money is used by the paper money printing-glut countries to buy key currencies (e.g. U.S. dollar) in order to depreciate their national currencies to support export-led growth and, thereby, to enjoy the surplus in *BOCUA*. As a consequence, the 'paper money printing-deficient countries' and/or 'saving-deficient countries' have been compelled to incur/bear the infliction of the cost of deficit in *BOCUA* and the depreciation of their national currencies.

In this context, it is noteworthy that the unprecedented depreciation of Indian currency in August 2013 had occurred owing to one or more of the points indicated by 1(i), 2(i), 3(i), 4(i), and 5(i).

Concluding Comments

Since at the equilibrium of international trade, the sum of surpluses in *BOCUA* of a group of countries (say, country group-A) is equal to the sum of deficits in *BOCUA* of another group of countries (say, country group-B), on the assumption that there are only two country groups in the world, so the realization of external balances of all the countries simultaneously is impossible in a globalized world.

Given the non-operation of national or world paradox of thrift, if all the countries adopt the principle of world paradox of paper money printing to improve their *BOCUAs*, no country will be benefited, as the competitive production of war-weapons by all the countries cannot increase their relative positions in the world war-weapon race.

If an international government and a unique international currency can be established in a cosmopolitan society, which will be guided by dual capitalism (Konar, 2010), which means the coexistence of social capitalism and ecological capitalism, then the principal of global Keynesianism (Kohler, 1999) can stabilize the cosmopolitan society both internally and externally.

Through the modifications of the saving-investment relationship by the introduction or incorporation of new variables into the equation 11(iv) , potential researchers can challenge the objectives or results of this article.

In this context, it is relevant to recall the remark of Keynes (1936, pp. 347-348) :

> …….there has been a chronic tendency throughout human history for the propensity
> to save to be stronger than the inducement to invest. The weakness of the

inducement to invest has been at all times the key to the economic problem. …….The desire of the individual to augment his personal wealth by abstaining from consumption has usually been stronger than the inducement to the entrepreneur to augment the national wealth by employing labour on the construction of durable assets. (pp. 347 - 348)

If such remark of Keynes holds true, then the national or global economy will go through internal economic imbalance indicated by recession or depression vis-à-vis external economic imbalance indicated by the current account surplus. Thus, national or global imbalances are inevitable owing to the operation of global paradox of thrift. Similarly, Makin (2013, p. 2) pointed out that if one smaller country, say Brazil or Mexico, pursues EMTF (easy-money-tighter-fiscal policy), it works in the sense that the resultant weaker currency boosts exports and reduces imports, helping mitigate the drag from tighter fiscal policy. However, if large countries representing the lion's share of global output all try to pursue EMTF, no one country succeeds, and fiscal consolidation cuts growth without relief being provided by more net exports. Hence, the paradox of global thrift emerges. But Leenabanchong (2012, p. 51) argued that with perfect capital mobility, surplus or deficit in current account should be a temporary situation, which should be self-corrected and benign.

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