

The charms of deferred cost



There are two main ways of buying a new car. One is to save up the cost little by little and get the new car when the money is all there. The other is to get the car now and defer paying the cost by resorting to some arrangement that permits us to do so and then save the money and pay the cost some time in the future. If the arrangement were not expensive, everybody would rather have the car now than later.

We call this “time preference”. It seems to be a very basic human trait. If instead of time preference we had “time indifference,” while money we saved brought a return in interest, rent and dividend, we would all starve to death, for we would by definition always prefer to save the marginal dollar and earn a return of a few cents on it than earn no return at all and spend the dollar on present consumption that we did not prefer to future consumption. However, saving is not governed only by time preference and the return on the capital we accumulate by saving. Its major determinant is income itself. Subsistence level incomes permit only little saving or none at all.

At the other end of our social order, astronomically high incomes are almost wholly saved for obvious physical reasons. The top 1 per cent of American households have an average annual income of roughly \$15 million. Even if such a household were to spend all of it, the part of actual consumption in its spending would almost certainly be infinitesimal. Housing, food and drink, domestic and other personal services and everything else billionaires really appropriate from the national product and imports, however lavish and luxurious they may be, can hardly absorb more than a single-digit percentage of billionaire incomes. If the rest is all spent on million-dollar

stamp collections, old masters canvasses or the endowment of university chairs, no part of the nations product is used up thereby.

It all adds up to saving, though its flow to industrial investment may pass through circuitous transfers. Saving is determined not only by income, but also by changes in income. There is some evidence that consumption is geared to past income, so that when income rises sharply, people consume less and save more from it than they would if their current income had been as high in the past as it is now. This seems to explain the extraordinarily high savings generated by the Asian “ tigers”, such as Taiwan, China or South Korean during their period of double-digit annual growth in the 1980s and 90s” precisely the period when they needed high saving the most. Other than time preference that reduces it and income that makes it grow, saving is determined by the contingencies of life. People strive to provide against incapacity in old age and for their childrens education. They also wish to leave something for them after they are gone, for giving children an easier start in life than ones own had been is a fairly universal ambition.

Despite all the progress we have been achieving, this ambition is now turning out to be very difficult to fulfill. Is there an entity called “ society”? Ever since World War II, when European governments, starting with the English, went to work building welfare states, the incentives individuals had to save were progressively weakened or even wiped out. This was done for incontestably well-meaning reasons by having individuals cares about the contingencies life taken off their shoulders and looked after collectively by society.

Individual provision against ill health, unemployment, and old age became less pressingly necessary. Society stood in as the willing protector. Margaret Thatcher was vilified especially on the occasion of her death, and blamed for many things she had never done, such as the vicious destruction of mining and manufacturing in the Northern half of Great Britain. One thing she was condemned for, however, she did do. She did say, perhaps a little maladroitly, that there was no such things as “ society”. Loose usage of the word implicitly suggests that society is a single actor having only one orderly mind and preferring only one thing over its alternatives. Except in imaginary communities where everybody is the clone of one and the same person, such as is the case in the much admired Rawlsian theory of justice, the suggestion of a unanimous, single-minded society is evidently false.

What is glibly called a “ society” is at least two persons with two minds, and a division into at least two halves along some dimension. At least two persons, a Well-to-do and a Needy person with interests opposed in some respect, though perhaps complementary in others, represents the class conflict that was for so long thought to be the mainspring of history. Another, in our day more relevant representation of society is two persons, Young and Old, the one less and the other more than about 24. Their interests have come to be sharply opposed. This is insufficiently recognised, and so is the reason why we do not adequately realise this. The way we use words reacts back on the way we think about what they must mean. The careless and glib use of a word reacts back on how its meaning is settled in our mind. Tacitly suggesting consensus, it gradually teaches us to think about society as one collective actor with one mind and no self-contradictory conflict within it.

Young is the victim and Old the unconscious beneficiary of this falsehood. Deferred cost: the old gain. The young lose more. Solicitous society relieves the old of most of the need to save so as to meet the cost of future contingencies. They can defer the cost and enjoy the satisfaction of their time preference. Cost deferral offers them another charm, too. Somebody must advance the cost they defer. Society obliges Young and Old to do so collectively.

Each contributes taxes, but these are not proportionate to the cost a particular taxpayer may be deferring. The cost the young are deferring are far away in the future but they pay for them in the present. For the old, the deferral is obviously shorter.

They lose less of the time preference the deferral allows them, while the young lose more of it. The young pay sooner than the old for the welfare they will eventually collect from society. This handicap, however, is as nothing to the unintended but almost inevitable consequence for the young of letting the old defer the cost of the indemnities that ease their old age. Their saving will fall below what it would have been. The contingencies of old age for which their saving are no longer there to cover should be covered by taxes on young and old but will always fall short, not as a logically necessary outcome, but as a matter of solid experience.

The shortfall swells both the budget deficit and the current balance of payments deficit. It gets added to the national debt. Servicing the national debt falls as an end-of-life charge on the old but as a full lifetime charge on those who are young today. Netting out indemnities received and taxes paid,

the effect of deferring the cost of the indemnities society secures for the old is that the latter rolls part of the eventual cost on to the backs of the young, who have to carry it through their lifetime.

In effect, the old systematically leave an increasing load of debt as legacy for the young. Keeping the rate of growth of the debt at or below the rate of growth of national income is compatible with the young not getting any poorer relative to the old. Arguably, it also responds to society's time preference, for it enables it to defer some cost of its present consumption. If, on the contrary, the national debt grows faster than the national income, not only is the future growing darker for everybody, but it is getting even darker for the young than for the old. For the reader who may have missed it, let us point to the grim humour only half hidden behind these mechanisms. To ward off eventual insolvency or for other reasons, most European governments are scrambling to curb their deficits.

The majority of their people are ready to vote them out, indignant at the austerity inflicted on them. Without really realising how outrageous is their indignation, they are furious at being prevented from getting their own children any deeper into debt in order better to enjoy the charms of deferral.;;?