CARTWRIGHT

Why Time is so Important for our Economic Health

In this article, we explain how the nature of the money system in a country's economy can dramatically affect the time preference of both individuals and companies. With it brings – as we are now seeing – huge implications for that country's economic performance and health.

A Phenomenon Called 'Time Preference'

The expression 'time is money' is true not just for individuals and businesses but also for the broader economy. One of the most important (though oft-ignored) factors that determine the health of an economy is a phenomenon called 'time preference'.

An individual or businesses time preference is the ratio at which they value the present over the future. Put simply, someone with a high time preference is particularly concerned with their wellbeing in the present and immediate future. While someone with a low time preference places more onus on their wellbeing in the more distant future.

Navigating a Far From Certain Future

Because humans do not live forever and death can come at any moment, the future for all of us is far from certain. And, as consumption is vital for survival today, people instinctively value present consumption over future consumption. A lack of present consumption could mean the future never comes.

Much the same can be said of companies. They generally prefer to have a given quantity of goods in their possession right now. This allows them to increase production today rather than, at some point in the future. For an individual or company to be willing to delay their receipt of a good by, say, a year, they would have to be offered a clear incentive, such as a larger quantity of the good. The increase necessary to convince an individual or a company to defer their receipt of a good is what determines their time preference.

Even going back to prehistoric times, time preference has played a key role in human development. Humans have always differed from other meat-eating animals by devoting time to developing tools for hunting. Some animals, particularly our relatives in the ape family, may occasionally use a tool to hunt another animal, but they have no capacity for owning those tools and maintaining them for long-term use.

A Lower Time Preference is an Investment in Time

It is only through a lower time preference that a human decides "to take time away from hunting and dedicate that time to building a spear or fishing rod that cannot be eaten itself, but can allow him to hunt more proficiently," writes the Austrian economist, Saifedean Ammous. This, he says, is "the essence of investment; as humans delay immediate gratification, they invest their time and resources in the production of capital goods which will make production more sophisticated or technologically advanced and extend it over a longer time-horizon." Because time is spent creating the capital good, the first consumer-good takes longer to produce than it would without the capital good. However, subsequent goods are produced quicker than without the capital good and so overall productivity of that good improves. It needs the human desire for delayed but greater overall productivity to motivate someone to spend time upfront creating the capital good. Instead of satisfying their immediate needs/desires.

This is how economies develop and grow, exponentially becoming more complex and advanced along the way. The lower an individual or company's time preference, the more likely they are to engage in investment, to delay gratification and to accumulate capital. The gradual formation of capital has fuelled economic development for centuries, boosting labour productivity and the general quality of life.

'Hard' Money Expects to Maintain its Future Value

There are many factors that influence the time preference of individuals and companies. Security of both people and property are among the most important. It is only natural that in societies where the government and/or criminals can expropriate your property or even put your life in danger, its people have higher time preference. These individuals prioritise spending their money on immediate gratification rather than saving for the future.

However, there is an even more important factor at work: the expected future value of money. If money in an economy is expected to maintain its value, it incentivises people to put off consumption and instead direct their energy and resources towards production in the future. This sets in motion a virtuous cycle of capital formation and improving living standards. This is generally the case when an economy is based on so-called 'hard' money. Hard money supply is largely inelastic. The best known (and tested) example of 'hard money' is gold, whose supply increases globally by 1-1.5% per year.

'Easy' Money and the Decline in Purchasing Power

But what happens in an economy where the value of money is in gradual free-fall, as has been the reality for most countries over the past half century? Since President Richard Nixon took the US dollar off the gold standard in 1971, the monetary system has not been backed by a precious metal, commodity or any other scarce resource. It is simply money by government decree or "fiat" – hence the term "fiat currency" – created out of nothing. As a consequence, there are virtually no constraints on how much money can be created.

Governments and central banks have taken advantage of this by printing unprecedented sums of money. The result has been a steady (but now accelerating) decline in the purchasing power of all national currencies. Even the best-performing forms of government-issued money have seen their value compared to gold evaporate since 1971, the year they were delinked from the monetary metal. The world's reserve currency, the US dollar, has lost 98% of its value during that time while gold has maintained its value.

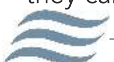
Governments and 'Price Stability'

Another key shift in that time is that central banks have taken to micromanaging interest rates. They call their mission 'price stability'. In reality, they have kept interest rates as artificially low as possible, arguing that low rates encourage borrowing and investing. However, artificially manipulating interest rates downwards also depresses the interest rate that accrues to savers and investors. In other words, not only is the value of the currency constantly falling in value, so too is the amount of interest paid. Therefore the incentive to save is reduced.

The result is inevitable. People stop saving for the future, society accumulates less capital, or even begins to consume its capital, and worker productivity stagnates or even begins to decline. People consume more of their income and borrow more against the future. The resulting debt crises grow in scale and severity. Just as centuries of capital formation helped to fuel unprecedented advances in labour productivity, economic development and quality of life, decades of capital destruction threatens to do the opposite. That is why time preference is so important for our economic health.

So what does all this Mean for Pension Trustees and Members?

It means that we're probably reaching, or have already reached, a tipping point. A point where the total capital accumulated over hundreds of years stagnates and starts to go into reverse. The headwinds of higher price inflation and higher time preference outweigh overall productivity increases. As such, general standards of living fall on average. Pension increases are unlikely to keep pace with the true cost of living. These negative effects will be felt most in those countries with weaker currencies with high money supply growth. There is likely to be a greater move to hard assets as people act to protect their purchasing power as best they can.



CARTWRIGHT

What we have described is a super-cycle that will not be easy to reverse. It can easily be missed if we focus only on the day-to-day detail. Part of investing is about second-guessing how other people will act or react and acting before them (which draws in capital and creates solutions sooner).

There would also seem to be huge implications for the level and type of future pension provision in the UK.

What do you think?

Is this too much doom and gloom? Please let us know if you would be interested in a roundtable discussion to explore these ideas further, in a positive way, to find better solutions.

If you would like to discuss any of these matters further, please get in touch with your usual contact at Cartwright.

March 2024

Cartwright Benefit Solutions Limited is registered in England & Wales N. 08327237. Registered Office: 250 Fowler Avenue, Farnborough Business Park, Farnborough, Hampshire, GU14 7JP. Cartwright Benefit Solutions Limited is Authorised and Regulated by the Financial Conduct Authority: Registration No. 607200.

No action should be taken based on this research note without the trustees of the relevant occupational pension scheme receiving written investment advice from Cartwright Benefit Solutions Limited confirming the suitability of the investment decision for that particular occupational pension scheme.

250 Fowler Avenue
Farnborough Business Park
Farnborough
Hampshire GU14 7JP
T: 01252 894883
E: enquiries@cartwright.co.uk

Marlborough House
Victoria Road South
Chelmsford
Essex CM1 1LN
T: 01245 293300
E:
enquiries@cartwright.co.uk