The role of savings and investment in the world economy

Savings and investment play an important role in our world economy. Consumption is expenditures by household on final goods and services. Saving is the part of the disposable income that is not consumed at present investment means the purchase of capital goods (such as land, Equipment, building e. t. c). If a society invests more in capital, it must consume less and save more of its current income. It requires that society sacrifices consumption of goods and services in the present to enjoy higher consumption in the future. Nations that save and invest large fraction of their incomes tend to have rapid growth of output, income and wages.

Savings can be subdivided into private saving. Public saving, national saving e. t. c. Investment includes tangible capital such as houses and intangible investments such as education. Again, investment can be Net investment or Gross investment. Net investment is the value of total investment after an allowance has been made for depreciation. Gross investment is an investment without allowance for depreciation. In finance terms, " Investment has an altogether different meaning and denotes the purchase of a security, such as a stock or a bond". Saving can be influenced by level of consumption, Population growth, political stability or instability, the rate of income e. t. c. It is known to us, saving influences over investment in an economy. So saving is very crucial topic to investment. If the rate of saving is increased, it means the increase rate in investment or capital accumulation or efficiency in productivity.

ANALYSIS OF THE TOPICS

* Private saving:

Private saving is that part of disposable personal income that is not consumed. Personal saving equals Personal income minus Personal outlays (i. e. consumption and interest). In general, Personal saving is the income of individuals which can remain on their bank accounts for future use or can be directly invested in houses, bonds, shares and other financial instruments.

We can explain personal saving in the following way:

Let, Mr. X ‘ s income is tk 20, 000. According to government tax rules and regulations he pays the government tax 2, 000. So, Mr x’s disposable income is Tk (20, 000-2, 000) = Tk 18, 000. when the disposable income of Mr is Tk 18, 000, at that period Mr x’s consumption is Tk 16, 000. So Mr x’s saving is Tk (18, 000-16, 000)= Tk 2, 000.

From the above calculation we can briefly write down how the personal saving ean be found.

Personal Income Tk 20, 000

(Less) : Personal taxes Tk 2, 000

(Equals) : Disposable Personal Income Tk 18, 000

(Less) : Personal outlays Tk 16, 000

(Including consumption and Interest)

(Equals) : Personal Saving Tk 2, 000

*Public Saving:

Public saving is the government income basically tax revenue that the government has saved after paying for its spending. Ordinary Government saves a partial amount of the income for serving several purposes such as human activities for the country’s development or gives the people certainty

For good health, education and other social welfare. Public saving equals tax revenues minus public expenditures.

*National saving:

National saving equals private saving plus public saving which remains after providing consumption and Government expenditures. Actually, National saving is the combination outcome of personal business and state saving. Now, Come to the point on Business saving, When Business or any financial institution earns a lot of profit, then it saves a partial amount to fulfill the future needs or to generate business components. Businesses save in that period, when they do not actively distribute its profits /dividends among the participators/ shareholders.

National income, Consumption, saving and Investment play an important role in displaying a nation’s economic performance. These elements are closely related. Saving indicates the amount that remains after paying for consumption and Government purchases. When saving is invested;’ used to purchase new capital goods is called investment.

We can use a model for showing National Income (GDP): (For closed Economy)

$Y = C+I+G$.

Here, Y = National Income

C = Consumption

I = Investment

And G = Government purchase.

National saving indicates the amount that is not spent for consumption and Government purchases. Anything that amount is not consumed is pretended to be invested.

National savings â†’ Y-C-G= I

Replacing S for Y-C-G, We can write the equation as:

S= I

National saving is the combination of private saving and public saving. Private saving is the amount of income that households have left after paying their taxes and for their consumption. Public saving is the amount of tax revenue that Government has left after paying for its expenditures. Therefore, a new term T comes in the Equation:

S= (Y-T-C) + (T-G)

Billions of dollars

Disposable income Savings

Consumption

Years

We can explain disposable Income, saving and consumption from the above graph, in where years are shown on horizontal Axis and the amount of dollars and shown on vertical Axis. Say for Example, in 1930 a country's income (Disposable) was 3, 000, and then its saving will be Disposable income less consumption. We can calculate the Gap between and investment using the saving method. It can be noted hereby that, if the consumption increases, saving will decrease and vice versa.

Statistics in Saving & Investment:

TABLEA (saving as Percentage of GDP)

FY

Domestic Saving

National Saving

2001-2002

18. 16

23. 44

2002-2003

18. 63

24. 87

2003-2004

19. 03

25. 44

2004-2005

20. 01

25. 84

2005-2006

20. 25

27. 67

2006-2007

20. 35

28. 66

2007-2008

20. 31

30. 21

2008-2009

20. 01

32. 37

Source: Bangladesh Bureau of Statistics (BBS)

Table A Presents the year-wise rates of domestic and national savings for the last few years. In FY 2001-02 domestic and national savings as percentage of GDP were 18. 16 and 23. 44 Percent respectively. Domestic and national savings had reached to 20. 31 to 30. 21 percent of GDP respectively in FY 2007-2008. According to provisional estimates, the rates of domestic and national savings have been assessed to be 20. 01 and 32. 37 percent of GDP in FY 2008-2009. From the table It is clear that there is a continuous increasing trend of national savings but domestic savings as percent of GDP has been decreasing since FY 2007-2008 .

TABLE B (Investment as percentage of GDP)

FY

Total Investment

Public Investment

Private Investment

2001-2002

23. 15

6. 37

16. 78

2002-2003

23. 41

6. 20

17. 21

2003-2004

24. 02

6. 19

17. 83

2004-2005

24. 53

6. 21

18. 32

2005-2006

24. 65

6. 00

18. 65

2006-2007

24. 46

5. 45

19. 02

2007-2008

24. 21

4. 95

19. 25

2008-2009

24. 18

4. 63

19. 55

Source: Bangladesh Bureau of Statistics (BBS)

Table B shows the year-wise investment as percentage of GDP for the last few years. In FY 2001-2002 the rate of total investment was 23. 15 percent of GDP in which the shares of public and private sectors were 6. 37 percent and 16. 78 percent respectively. The rate of national investment gradually picked up to 24. 65 percent of GDP in FY 2005-2006 but in FY 2006-2007 it declined to 24. 46 percent. In FY 2008-2009 the rate of national investment further declined to 24. 18 percent.

FINDINGS

The planning and implementation division should be restructured to make economic development. We have to create a favorable investment climate around the world changing the old tradition savings and investment pattern, the Government will be able to increase its public expenditures up to 20 percent to 16 percent. We have to attract 30 percent more investment than the present level to become a middle income country. For this, We can encourage large scale private investment from both domestic and foreign entrepreneurs. Bangladesh is victim of climate change. Nobody comes forward with investment when the question of mitigating environmental risks comes. The existing financial institutions that deal with climate fund are not equipped enough to extend support and encourage investment in the risk management areas. Therefore, these financial institutions have to shape in a proper way. Distinction should be made carefully between the two components of domestic saving, private saving and public saving as the effect of political instability on private savings are likely to be significantly different from those on public savings political drastically should reduce. The absence of a stable socio economic framework will negate the stimulating effects of economic forces on saving and growth. Since higher export earnings and remittances from abroad are found to cause a higher saving rate, The Government should pursue economic policies to vigorously promote exports of commodities as well as manpower abroad Pro-export policies such as granting easier credit access to exporting firms, establishing more export processing zones, actively aiding the exporting firms for seeking foreign market, revising and updating the archaic business rules and regulations e. t. c would support the existing exporting firms and draw more entrepreneurs into the export sectors. Most saving studies have generally included subsets of the following economic variables as determinants of domestic savings. the GDP, growth rate, per capita income, export earnings, real interest rate, foreign capital, inflation rate, age dependency ratio e. t. c.

POLICY RECOMMENDATION

Policymakers should remain wary of the linkage between reduced economic growth and a lower saving rate, which in turn reduces future economic growth potentiality and thus sets a vicious cycle in motion. According to samuelson and Nodhaus-

The reasons behind the sharp decline in the personal saving rate:

Social security system: According to life cycle model, a household would save during working years to build up a security in future after retirement. When the Government collects social security taxes and pays out social security benefits, people have less need to save for retirement. Other income support system have a similar effect, reducing the reed to save for a rainy day. Corps insurance for farmers. Unemployment insurance for workers and medical care for the poor elderly all alleviate the precautionary motive for people to save.

Capital market: Capital market allows people to borrow more easily. One example is the proliferation of credit cards , which encourage people to borrow. Some believe that the availability of easy credit reduces savings among those who have little in liquid assets.

The rapid growth in wealth: The reason behind the decline in the personal saving is caused by the rapid increase in personal wealth, primarily due to exploding in capital market. From 1995 to 1999 for example, the value of stocks rose by about $5 trillion. If household spent 3 percent of this gain each year, the wealth effect would lower the personal saving rate by about 3 percent points.

Businesses buy capital goods when they expect that this action will earn them a profit- that is, will bring them revenues greater than the costs of the investment. This simple statement contains three elements essential to under standing investment: revenues, costs and expectations:

Revenue: The overall level of output (Or GDP) will be an important determiner of investment. When factories are lying idle, firms have relatively little need for new factories. So, investment is slow. More generally, Investment depends upon the revenues that will be generated by the state of overall economic activities.

Cost: The second important determiner of the level of investment is the cost of investing. It means the costs of borrowing. It is the given interest rate on borrowed funds. Additionally taxes can have a major effect on investment. Sometimes the Government gives tax breaks to particular activities or sectors., For example, The Government encourages home ownership by allowing home owners to deduct real- estate taxes on mortgage interest from their taxable income.

Expectation: The third is Expectation to determine investment. It means profit expectations and business confidence. If business are concerned that political conditions in Bangladesh are unstable, they will be reluctant to invest there. Conversely, if business believe that (rightly or wrongly) that Internet commerce will be an important feature of the distribution net work, they will invest heavily in that sectors.

CONCLUSION

From the above discussions, It is proved that the whole purpose of the cost benefit analysis is to select the projects for investment or lay down the investment criteria where no projects are inter dependent or mutually exclusive and where there are no constraints. The projects which maximizes the present value of total benefits less total costs can be indicated as under:

We have to select all projects where the present valve of benefits exceeds the present value of costs.

We have to select all projects where the ratio of the present value of benefits to the present value of costs exceeds unity.

We have to select all projects where the constant annuity with the same present value of benefits exceeds the constant annuity (of the same duration) with the same present value as costs.

We have to select all projects where the rate of return exceeds the chosen rate of discount.

Generally, Investment should be made in those industries which produce commodities having a readily available demand. Now, we can understand easily that saving is the part of Disposable Income. Saving creates investment which is resulted in capital accumulation. productivity gain, growth e. t. c. If saving is not kept in a proper way, a nation will not reach its desired goal. It is also true that the rich countries have more tendency to save and the poor countries have less tendency to save. Saving tendency may be caused by a nation's level of income. Saving is the key determiners to determine a country's standard of living. Saving leads a country to prove its competency or quality relative to other countries around the world. Necessary steps should be taken to increase savings and investment tendency in the people both private and public sectors by the Government and world leaders.