

What to do with the Savings Glut?

Tuesday, Jul 28, 2009

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Bangladesh seems like an unlikely country to have excess savings. Yet, that is exactly the impression one would get looking at the aggregate picture of savings. Our hard-working population is not only churning out income at a higher rate every year (6 percent plus GDP growth), they are also saving a good part of it – nearly 30 percent of GDP. Our migrant workers are known to be saving and sending pretty much all of their hard-earned wages. Two questions emerge from our present state of savings: is it a good or bad thing to have excess saving? Are we putting our savings to good use?

It was John Maynard Keynes, the leading economist of the 20th century, who popularized the notion of paradox of thrift (or paradox of saving). The paradox states that if everyone saves more money during times of recession, then aggregate demand will fall, lowering income generation, which will in turn lower total savings in the population because of the decrease in consumption and economic growth. The paradox is, narrowly speaking, that total savings may fall even when individual savings (as a percentage of income) rises, and, broadly speaking, that increases in savings may be harmful to an economy!

The Bangladesh case is not exactly akin to the Keynesian paradox but has a flavor of it nonetheless. It was in 2006, at a meeting of the Planning Commission to finalize the Poverty Reduction Strategy Paper (PRSP), that I pointed out that the PRSP – a medium-term planning document – had ignored an emerging paradox of excess savings over investment, an event which began around fiscal year 2002 [Fig. 1]. Planners had not taken notice of the fact and so there was no strategy to address this. For thirty years prior to that, Bangladesh, like every other non-oil developing country, ran a savings deficit which had to be met from inflow of foreign savings to match the demand for investment. Reliance on concessional foreign aid (i.e. foreign savings) for financing bulky infrastructure investment was justified by

development theory (Big Push a la Paul Rosenstein Rodan) and post-war global practice. Now that we are paradoxically running a savings surplus over investment, we should be asking why in the world should we need foreign aid to finance investment?



To be sure, two things were happening in concert. In aggregate terms, the economy was accumulating savings at a faster rate, thanks largely due to a surge in remittance inflow. So, the gross national savings reached a figure of 29 percent of GDP in FY08, and is expected to reach 31 percent in FY09, from only 18 percent in 2002. At the same time, our gross domestic investment has been stuck at 23-24 percent since 2002. What is striking is the switch in the composition of this investment – a rise in private investment and a fall in the share of public investment, which reached a low of about 5 percent (out of 24 percent) in the latest fiscal year. The savings-investment “surplus” now stands at 5 percent of GDP – resources equivalent to the cost of three Padma Bridges! I know of no other non-oil developing country (except China) that has such a huge savings surplus [Table 1 presents a sample of developing countries with their savings, investment, and current account balance as a ratio of GDP]. So much of savings is going waste when the economy is crying for resources to invest in infrastructure, health and education.

| Table 1: Savings, Investment, Current Account Balance 2006-09 (%GDP) | | | | |
|--|---------------------------|------------------------|-----------------|-------------------------|
| | Gross Domestic Investment | Gross National Savings | Savings Surplus | Current Account Balance |
| Bangladesh | 24.2 | 29.2 | 5.0 | 1.0 |
| India | 35.9 | 37.1 | 1.2 | -2.89 |
| Pakistan | 23 | 24 | 1.0 | -8.37 |
| Sri Lanka | 27.2 | 22.7 | -4.5 | -7.32 |
| Nepal | 28 | 28.5 | 0.5 | 2.62 |
| China | 42.9 | 48.7 | 5.8 | 10.00 |
| Vietnam | 38.7 | 32.8 | -5.9 | -9.38 |

Source: Asian Development Bank (ADB)

First and foremost, it signifies our inability to invest all our available resources. Second, it could be that our financial intermediation is not efficient. Savers and investors are two divergent groups. It is the financial system – banks and non-bank financial institutions – that bring savers and investors together. In a smoothly functioning financial system, such an excess of savings (investible capital) would have reduced interest rates, increased the

demand for investment and restored savings-investment equilibrium. That none of this is happening tells us that there is some stickiness or major inefficiency in the financial intermediation process. Third, we have been made aware of the poor performance of ADP implementation in recent years, which has had the effect of reducing the share of public investment in total investment. Problems with power and infrastructure have pulled back potential private investment as well. Lately, the global economic slowdown has compounded the problem. So the overall investment climate has not been conducive to result in an improvement in the investment-GDP ratio, which has remained stagnant for nearly five years and shows no sign of improvement.

There is one more dimension to the paradox not to be ignored. There is a one-to-one relationship between current account of the balance of payments and national accounts. For several years running, our current account has been posting a modest surplus, which was close to one percent of GDP in the last fiscal year. A current account surplus implies that the economy generated more income from domestic production and foreign earnings (remittances) than it spent on goods and services – domestic and foreign. In national accounting terms, this corresponds to the excess of savings over investment. That is to say, the savings-investment surplus should equal – or approach equality with – current account surplus, which should then be also 5 percent of GDP rather than only one percent. How do we explain the incongruence of the two figures?

The aggregate economic relationship point to the fact that some of our national savings is not invested in the domestic economy but abroad. In the absence of capital account convertibility, this would not be permissible, though India has allowed Indians to invest abroad under limited convertibility of the capital account. It is common knowledge that a significant part of worker remittances might not be coming through official channels. That creates one scope, among others, for investment of national savings abroad. In addition, both exporters and importers have multiple conduits – well known to those who manage the country's financial system – for parking resources abroad outside the purview of the non-convertible capital account regime.

All this points to the fact that capital in the present day and age could be quite mobile. It would be naïve to think that all savings of Bangladeshis are in the domestic economic system. Although our current account is convertible (done in 1994), non-convertibility of

capital account puts numerous bounds on current account transactions. So the incentive for parking domestic capital outside is not eliminated. These days, with interest rates in developed financial markets being at near zero, the relatively high returns in domestic banks and financial institutions should attract resources parked outside the country to be ploughed back in though other uncertainties of life and limb in Bangladesh might still prompt the flight of capital. I reckon it is only a matter of time when restrictions on outward and inward movement of capital will have to be relaxed, even under the regime of non-convertibility. This is more so because of the new initiative of government to encourage public-private partnership (PPP), particularly in mega-projects. Unless the restrictive rules of capital mobility are relaxed, it will remain a battle for private capital to move in or out; and an uphill task for those in the private sector trying to mobilize funds from international capital markets.

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