20 Savings and Investment Spending

MODULE 20

SECTION **6** SAVINGS, INVESTMENT SPENDING, AND THE FINANCIAL SYSTEM

Krugman and Wells
Macroeconomics in Modules, *Third Edition* / Economics in Modules, *Third Edition*

Matching Up Savings and Investment

- Total output = total spending. Total spending consists of consumption spending ($C + G$) and investment spending (I):

$$\text{GDP} = C + G + I.$$

- Total income = consumption spending + savings. Total income can go to consumer spending (C) or government spending (G) or be saved (S):

$$\text{GDP} = C + G + S.$$

- Putting these equations together, we get:

$$C + G + S = C + G + I$$

- Subtracting ($C + G$) from both sides:

$S = I$ or savings = investment spending.

Matching Up Savings and Investment

Now let's look closer at savings in a closed economy.

- Households save. Call it private savings, $S_{Private}$.

$$S_{Private} = GDP - T + TR - C$$

- Governments save (dissave) too. Call it public savings.

$$S_{Public} = T - TR - G$$

- National savings, S, is the sum of the two:

$$S = S_{Private} + S_{Public}$$

Matching Up Savings and Investment

- A **budget surplus** is when $S_{Public} > 0$.
- A **budget deficit** is when $S_{Public} < 0$.
- The **budget balance** is the difference between tax revenue and government spending.
- Remember that S_{Public} includes federal, state and local levels.

Matching Up Savings and Investment

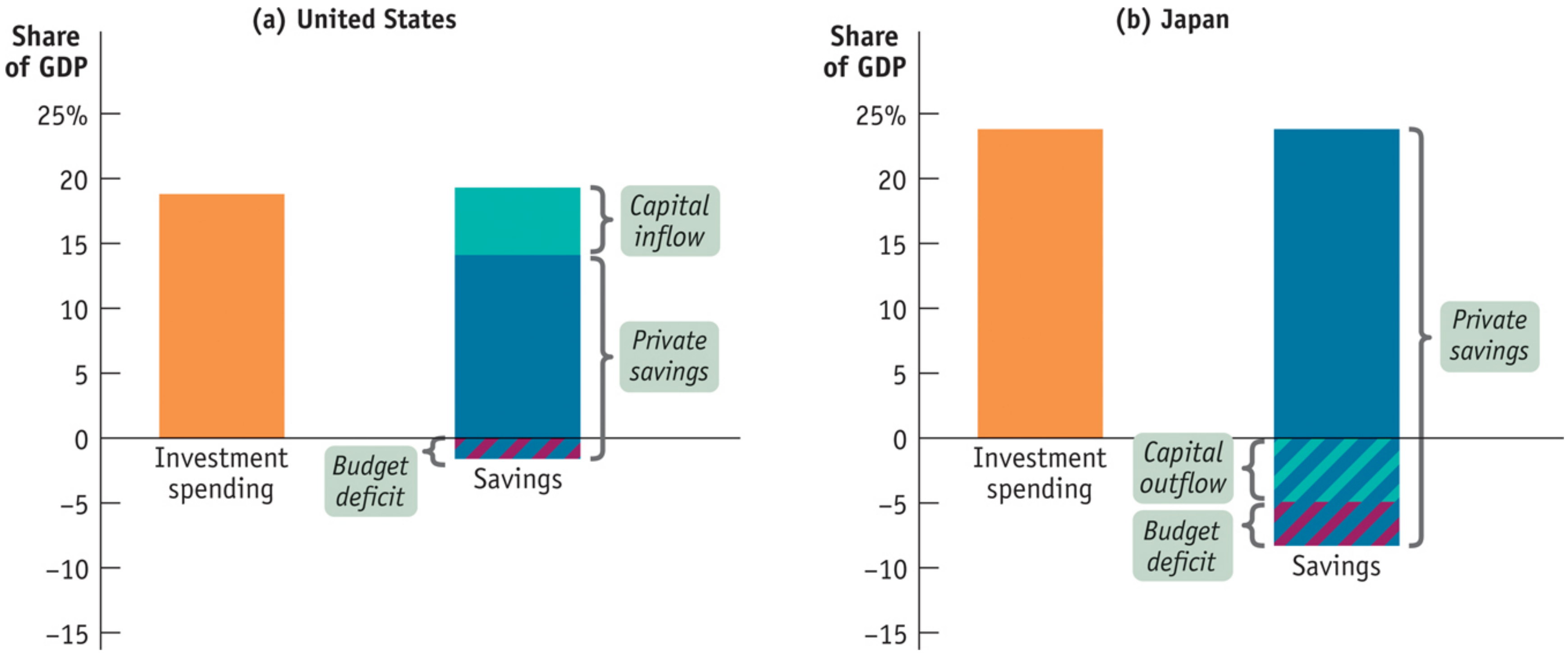
Now let's open up the economy….

- An **open economy** is an economy in which goods and money can flow into and out of the country.
- **Capital inflow** is the flow of funds into a country.
- **Capital outflow** is the flow of funds out of a country.
- **Net capital inflow** is equal to the total inflow of foreign funds minus the total outflow of domestic funds to other countries
- Investment spending (I) =

  National savings (S) + Net capital inflow (NCI)

Matching Up Savings and Investment

The Savings-Investment Spending Identity in Open Economies: The United States and Japan, 2007



AMERICA'S LOW SAVINGS

- Why do Americans save so little? Easier access to credit? Guaranteed Social Security?
- Because of large capital inflows we have been able to maintain high investment spending despite low national savings.