EC1506 Essay

The recent economic climate resulted in a decline in business and consumer confidence in the UK economy, leading many households to increase their level of savings. Do you agree that an increase in savings will lead to an increase in the level of investment expenditure in the economy? Explain your answer using relevant economic theory.

# Introduction

Get some numbers for UK economy. Show that this saving is actually happening.

-Big question: Is this good?

-What will investment expenditure do? What is it?

-What is the question, and how will I tackle it?

“Investment is expenditure on capital equipment and building by firms and expenditure on new residential houses by households. It also includes the change in firms’ stocks or inventories.”

The jist of it:

Y= total expenditure = total income = total output -- In a closed economy.

Income(y) = consumption + saving

AND

Expenditure(y) = consumption + investment.

Therefore:

Saving = investment.

HOWEVER:

This does not take into account stock building(inventory accumulation), which counts towards investment.

Therefore, if consumption falls but investment in new capital stays the same, measured investment rises because firms accumulate inventories of the goods that consumers did not buy.

Basically companies make more stuff than what is bought, and that is counted towards investment. However, a lot of companies use Just in time methods, so they don’t stockpile.

This means that if stockpiling happens, depending on the good, it is bad because the goods will go bad. Companies should look out for drops in consumption as stockpiling is often inefficient.

However, if firms lower demand, incomes and savings fall. Eventually the initial rise in savings is reversed because overall income has fallen.

However, textbooks focus on aggregate savings = investment. They mean that eventually S = Buying new goods ( not stockpiling). This is called the paradox of thrift. A desire by consumers to increase savings ends up just reducing output and savings do not increase at all. So basically the ratio of income to savings increases, but since income decreases due to reduced output, savings do not actually increase.

Increased savings makes it cheaper to borrow (lower interest rates) to encourage investment right?

Maybe, maybe not. However, if output is falling, firms may be reluctant to add to their capital stock.

# Body

Find a relevant economic theory.

Keynesian model?

Go through it. Discuss relevant points.

# Conclusion

Concluding paragraph, make your final point. Think about your perspective and it’s limitations.

# Essay feedback:

Focus on topic (question answered, focus on topic)

Reading and understanding. Breadth and depth of study

Analysis- critical reflection. Depth of analysis

Structure- ordering of ideas

Use of evidence

Style and presentation

# Bibliography

Research with Parkin’s book

-find economic theory to use

-information on saving vs. investment

Parkin. Eight edition.2012.

Stimulate saving

“Saving finances investment, so stimulating saving increases economic growth. The East Asian economies have highest growth rates and the highest saving rates. Some African economies have the lowest growth rates and lowest saving rates.” Page 524

“Economists claim that a tax on consumption rather than income provides the best saving incentive”. Page 525

“Investment increases the quantity of capital”.

“Saving is the amount of income that is not paid in taxes or spent on consumption goods and services. Saving increases wealth.” Page 534

“Saving is the source of funds that are used to finance investments, and these funds are supplied and demanded in three types of financial markets:”

Loan markets, Bond markets, stock markets.” Page 535.

Loanable funds market.

Funds that finance investment.

* Household saving
* Government budget surplus
* Borrowing from the rest of the world

Y ( Household’s income) = C + S + T (Page 538)

Y = sum of aggregate expenditure = C + I + G + X – M (page 462)

Subtract: I = S + (T-G) + (M-X)

Investment is financed by household savings, the government budget surplus and borrowing from the rest of the world.