[Frequently Asked Questions]

Financing Development

Subject:	Business Economics
Course:	B. A. (Hons.), 6^{th} Semester, Undergraduate
Paper No. & Title:	Paper – 641 Elective PaperE2 – Economic Growth and Policy
Unit No. & Title:	Unit – 4 Technological Progress
Lecture No. & Title:	Lecture – 2 Financing Development

Frequently Asked Questions

Q1. How are savings classified?

A1. Savings can be classified based upon the saving class, willingness to save and time period (saving term).

- Based upon the saving class, savings are private savings and public savings.
- Based upon the willingness to save, savings are voluntary savings, involuntary savings and forced savings.
- Based upon the term of savings, savings are short term savings, medium term savings and long term savings.

Q2. What is meant by private savings?

A2. Private savings are the savings of the private sector of the economy. Individuals save money from their disposable incomes by curtailing consumption and private businesses save out of their profits.

Q3. What is meant by public savings?

A3. Public sector can save if it incurs lower expenditures than the incomes on revenue account (current account) of the budget. In other words, public sector can save when governments run a surplus on the revenue account of the budget.

Q4. What is meant by voluntary savings?

A4. Voluntary savings arise when households and businesses voluntarily spend lesser than their respective incomes.

Q5. What is meant by involuntary savings?

A5. Involuntary savings arise because of involuntary reduction in consumption caused by taxation or compulsory savings schemes introduced by the government for the public. These are in a way the government's means of borrowing from the public.

Q6. What is meant by forced savings?

A6. Forced savings refer to the accumulation of money because of the real balance effect created during inflation. In times of inflation, people feel that the value of their accumulated money is depleting. Hence, to keep the value of their money constant, they accumulate more money by reducing the proportion of income spent on consumption and this is called the real balance effect.

Q7. How do savings arise in a situation of underemployment according to Keynes?

A7. According to Keynes, when the economy is functioning at less than full employment level, governments can afford to spend more in the economy than what they earn by way of deficit financing. The investments undertaken by the government through excess spending will result in higher employment, higher incomes and subsequently higher savings.

Q8. How do savings arise in a situation of full employment according to Keynes?

A8. If an economy is at the full employment level, an excess spending by the government will lead to a situation of excess money supply and inflation. The higher level of prices will then reduce the demand for consumer goods and make people save more to keep the value of their real savings constant. This way, savings rise.

Q9. How can government undertake investment for development according to the quantity theory of money?

A9. According to the quantity theory of money, people hold cash on hand to buy goods and services. If the state wants people to save more, it must raise taxes so that the demand for cash on hand reduces, and people's purchasing power is transferred to the state. The state can then spend the enhanced tax revenue for development.

When there is inflation, people will hold more money to keep their real purchasing power (real balance) constant. During inflation the state can raise taxes in proportion to inflation and thus reduce people's consumption.

Q10. How can the government increase savings and investments in developing countries?

A10. Developing countries are plagued by poverty, unorganized sector, less developed financial sector and a large non-monetized sector. All these characteristics tend to reduce savings.

- Hence, the income of poor must be raised by proper fiscal measures and by developing microcredit systems. When incomes of poor rise, the private sectors' savings will rise.
- The unorganized sectors must be made more organized and regularized so that their incomes are recorded and due taxes are collected. Taxes raise government savings and investment.

- Financial sector reforms must be undertaken in such a way that the market for funds works efficiently in mobilizing savings and investments.
- The barter transactions and non-monetized modes of payment must be prevented by increasing awareness and improving banking facilities in the most remote areas also. Monetization will bring the incomes of people and transactions on record will increase the amount of deposits with banks. The capacity of banks to mobilize these deposits for investment will thus increase.