Keynesian Interpretation of Saving and Investment

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Though the output of literature on 'Economic Analysis'' has in recent times reached massive proportion, but so far our use of the terms 'Savings and Investment' has been ambiguous. It is only in the literature of the past twenty five years, that any attempt has been made to state precisely what these concepts mean. When the economists, began to study this complex riddle, fresh difficulties arose and a long range of complicated controversy ensued, which has come to an end only recently.

Income in the current period is defined by Keynes as equal to current Investment plus current Consumption expenditure. Saving in the current period more-over is defined as equal to current income minus current Consumption.

Let income be called Y, Investment I, Savings S.

Then $Y = I + C$ I

Also $S = Y - C$ or $Y = S + C$ II

Therefore $S = I$

From the above two equations we can derive the conclusion that Saving is equal to investment.

Moreover the logical identity of Savings and Investment refers to aggregate Savings and Investment. The identity holds good, regardless of the seemingly paradoxical fact, that an individual can save more than he invests. Obviously there is no reason, why an individual's saving should be equal to his Investment, yet from the point of view of the community, all individuals, cannot save more than they invest. This is true, because an excess in an individual savings over investment is exactly off set by a deficiency in other's savings.

This equality of Saving and Investment follows from Keynes' definitions. But the main confusion lies in the fact that it is very different from the other proportion that as demand and supply are brought into equilibrium by the equilibrating mechanism of price, so are Savings and Investment equilibrated by the fluctuations in the level of incomes. It is quite consistent with the following passage, "the novelty in any treatment of saving and investment consists not, in my maintaining their necessary aggregate equality, but in the proposition that is not the rate of interest but the level of income which (in conjunction with certain other factors) ensures their, equality." A perplexing question that may baffle one arises, if savings and investment are always equal by definition, why should, a change in income ever occur?

Now this problem and confusion has been cleared up. As early as 1930, Professor Myrdal began to distinguish between Savings and Investment, '*ex ante facto*', and '*ex post facto*'. It is the latter that Keynes had in mind, when he showed Savings are equal to Investment; '*ex post facto*' savings and investment must be equal, because sales and purchases must be equal. This equilibrium thus achieved corresponds to Marshall's market equilibrium. It is not necessarily a stable equilibrium. Saving and Investment are always equal in this sense but they are not always in equilibrium. If the economy is in a moving equilibrium, so that the variables are always in a normal 'desired' functional relation to each other, then of course, Saving and Investment will not be only equal but will also be in equilibrium. But if this process involves expenditure lag or production lag, Saving and Investment, though equal, will not be in equilibrium until the lags have been worked through. This is true whether the economy is in stable or moving equilibrium.

In connection with the other type of Savings and Investment (*i.e. ex ante facto*) we mean savings which people would do if their intentions were nor off set by business being either better or worse then was expected. The nearest we can cone to an exact definition of it 'is the tendency or propensity to leave some part of income unconsumed'. In this sense we can say that Savings are more or less than investment.

The meanings of the '*ex ante*' concepts is still rather vague and ambiguous. What is the significance of the equality of psychic plans in the minds of savers and investors. "How can future savings constitute a supply of credit and affect the bond market before they are actually made." Planned Savings and Investment are misleading substitutes for *ex ante*, because of the fact that planned savings arid investment do not refer to the future, as the later does. So all this confusion is due to the unfortunate use of 'planned' for *ex ante*, for 'planned' suggests some psychic activity, which cannot by itself influence the course of events. Thomas Wilson, a famous economist writes that the proper translation is "attempted", which makes quite clear the meaning of '*ex ante*'. It is here that disequilibrium may arise out of savings and investment and trade cycles become the effect of this cause. It is true that purely internal forces can start the upswing and lead to the early stages of hyper-inflation, but finally the labour scarcity and changing expectation, being extremely important will have their effects; and after some time, the elasticity of expectation may become negative, bringing the inflation to an end. Conversely during a depression, the elasticity of sales expectations may again become negative, if the decline has proceeded beyond a certain limit and although in this case savings exceed investment, business men may enlarge their out put and thus may bring recovery. The divergence between savings and Investment, will not be of a cumulative nature because of the fact that changes in the elasticity of expectations, will check the fluctuations in either direction.

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