

Analysis of domestic saving and economic growth in Australia and Korea

Chengrong Li

College of Business and Economics, Australian National University, Canberra, Australia, 2600

ABSTRACT. *To analyses domestic saving and economic growth in Australia and Korea, the author gathered data on the domestic saving rate and economic growth of Australia and Korea over the past 10 years, and then explained how domestic saving rate is related to economic growth. Finally, the author gave perspectives about the domestic saving and economic growth in Australia and Korea.*

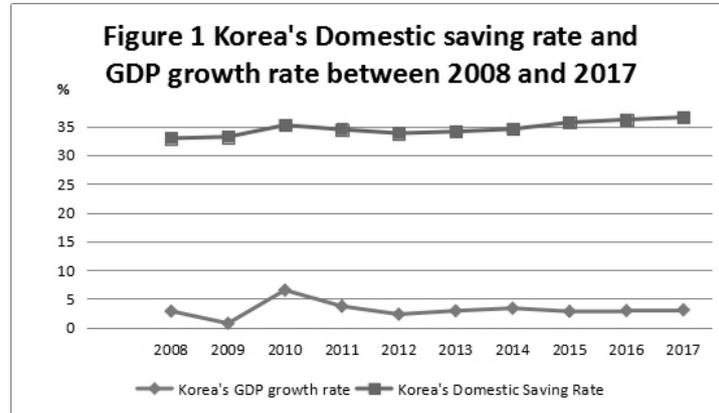
Keywords: *domestic saving rate, economic growth, gross domestic product (GDP)*

1. Introduction

Economic growth is defined as change or growth in Gross Domestic Product (GDP). In order to rapidly receive economic growth, governments often initiate public policies to develop the economy. This can be done by increasing domestic savings as an effective strategy to raise GDP in the long term.

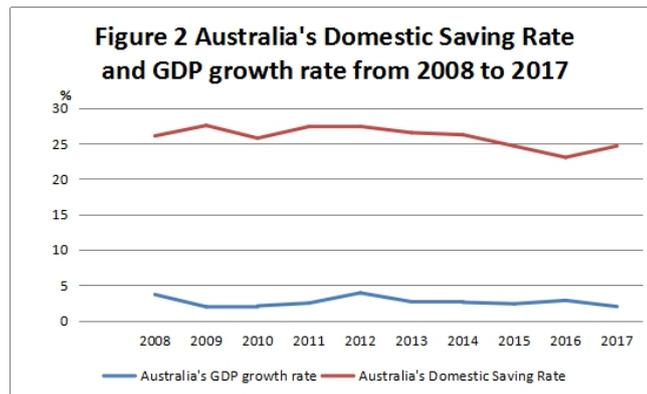
2. Analysis

First of all, governments can increase their GDP by raising the domestic saving rate in the long term. In the equation $Y=C+I+G+NX$, due to the increased domestic saving rate, which is equal to total saving divided by GDP, the higher amount of savings will be available for investment, and therefore the total GDP (Y) will also produce an increasing trend. For example, by comparing the domestic saving rate with GDP growth rate in Korea from 2008 to 2017, the figure 1 shows that if the domestic saving rate increases, the GDP will also increases in the long run even though in the short run, the GDP may decrease. Specifically, in Korea, from 2012 to 2017, as the domestic saving rate increases from 33.796% to 36.571%, the GDP growth rate was always greater than zero, which means that GDP had an increasing trend. This means that in the long term, economic growth will be produced by increased the domestic saving rate. Thus, Korea should maintain the trend of increased domestic saving rate in order to develop economy.



Source: THE WORLD BANK, <https://data.worldbank.org>

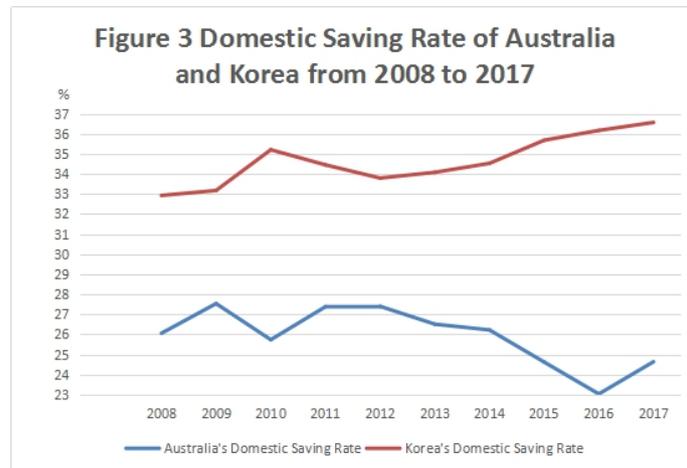
In addition, GDP increases, but at a decreased rate, caused by the increased domestic saving rate over the long run. In the equation $Y=AF(K, H)$, the quantity of physical capital (K) will be increased by raised domestic saving rate, but as a result of the law of diminishing product, the increased physical capital will lead to the quantity of output (GDP) increase at a decreasing rate. As shown in figure 2, between 2008 and 2009, in Australia, as the domestic saving rate increased from 25.056% to 27.537%, the GDP growth rate decreased from 3.658% to 1.923%. The evidence shows that the increased domestic saving rate will lead to GDP increases at a decreasing rate. However, in the short run, the increased saving rate will lead to less consumption, and therefore result in decreasing GDP. This decreased GDP in short term can be ignored by the government as it only has negative influence on economy over a short period. Therefore, in the long run, Australia should provide incentives that encourage saving today in order to increase the GDP in the future.



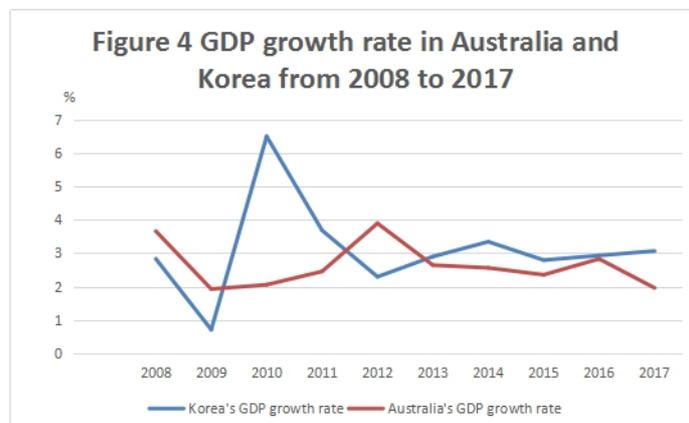
Source: THE WORLD BANK, <https://data.worldbank.org>

Finally, a country with higher aggregate savings will be able to accumulate capital faster through investment than other countries. For example, compared

Australia with Korea over the past 10 years in figure 3 and figure 4, from 2013 to 2017, it is clear that Korea has a higher GDP growth rate than Australia as the domestic saving rate of Korea is also greater than Australia. Specifically, in 2017, the figure of domestic saving rate in Korea was 36.571% but the figure of domestic saving rate in Australia was only 24.636%, this situation lead to the GDP growth rate in Korea was 1.5 times higher than Australia. The reason for this situation is that due to the higher rate of domestic savings, Korea has more funds available to invest in capital and technology in order to develop economy. The evidence shows that a nation, which has a higher domestic saving rate, will result in higher GDP due to higher level of ability to accumulate capital. Moreover, the choice between saving and consumption is affected by prices, expectation of future earnings and future taxes. For this reason, Governments should relatively adjust their policies to increase domestic savings in order to develop economic growth. Especially in poor and development countries, governments should encourage saving and therefore they will have enough money to produce more capital goods and invest in advanced technology to catch up the speed of growth on economy in developed countries (Aghion, Comin, Howitt, & Tecu, 2016). However, other public policies also can increase economic growth such as investment from abroad, improving education, health and other factors. However, increasing domestic saving rate can be a safer option, as it can provide funding in the event of a country encountering an economic crisis.



Source: THE WORLD BANK, <https://data.worldbank.org>



Source: THE WORLD BANK, <https://data.worldbank.org>

3. Conclusion

In conclusion, a trend of an increasing domestic saving rate will also increase GDP in the long term. The reason is that increased domestic saving rate will lead to government have more funds available to invest in physical capital and technology in order to increase productivity (Singh, 2010). The higher productivity will then directly develop economy. Therefore, governments should encourage saving to achieve economic growth.

Reference

- [1] Aghion, P., Comin, D., Howitt, P., & Tecu, I (2016). When does domestic savings matter for economic growth? *IMF Economic Review*, vol.64, no.3, pp.381-407.
- [2] Singh, T (2010). Does domestic saving cause economic growth? A time-series evidence from India. *Journal of Policy Modeling*, vol.32, no.2, pp.231-253.