Tomorrow's Affairs
Analysis of today
Assessment of tomorrow

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When governments spend a lot, citizens save less

Margaret Thatcher said in the 1980s: the state has no source of money ” other than the money people earn themselves. If the state wishes to spend more, it can do so only by borrowing your savings or by taxing you more. There is no such thing as public money, there is only taxpayers ‘money”.

The reason why I remind you of this quote is to stress further the never-ending problem of developing countries, which is poor savings rates.

In numerous articles, I have discussed that this problem is caused by governments’ occasionally wrong practices. Papers I authored from 2010 to 2016 were published in peer-reviewed journals.

However, they did not come to prominence until 2019, and when they did, they began to be quoted at an increasing rate. When things are going well, people do not tend to care about small mistakes that might potentially become problematic in the future.

We economists, on the other hand, try to sense the approaching dark clouds and warn others to take precautions before it‘s too late.

The late Thatcher made her bed when she violated her own counsel and let the budget deficit grow aggressively, and also when she brought in a new type of tax called the “poll tax”, levied on every citizen, regardless of their income or resources.

Reagan, too, acted quite contradictorily to what he said during his long term of office - one of them was constantly changing tax rates.

Turkish President Turgut Özal, the other member of the liberalisation trio, passed away while he was still serving as the President of the Republic, unlike Thatcher and Reagan.

During his long time in power, he was harshly criticised for letting the government getting extensively bigger. Although the wind of privatisation that started in the 1990s has subsided today, the expansion of the government continues at full pace.

We are now living in a country full of seriously indebted people due to their inability or failure to save money.

Both the government and the citizens are in debt to other entities. Increasing tax rates practically every day leads to a greater savings gap.

So, I think it might be more insightful to look at the theoretical and empirical causes of this problem.

> In developing countries, taxation is often not considered a function of economic growth

One of the notable differences between developing countries and developed countries is that, in developing countries, taxation is often not considered a function of economic growth.

Due to tax collection challenges in these countries, tax rates are usually kept high in order to generate resources for government spending.

Other than that, tax legislation in developing countries is quite complex. Tax rates may vary according to sectors, goods and services and even regions.

One of the reasons why the savings rates in developing countries tend to be low is due to high levels of government expenditure, which are covered by the government through constantly rising taxes - so much so that, sometimes these one-time charges introduced to create more revenue later become a permanent levy.

According to traditional fiscal theory, the government is an institution that should use private and public revenue in the most efficient way and distribute the country's total GDP amongst its population in the most just way.

However, the fact that a large part of tax revenue in developing countries consists of indirect taxes does not conform to the two basic principles of taxation, which are "equality and justice".

Tax increases affect private savings negatively and may even cause inflationary effects

The reality is that tax increases affect private savings negatively and may even cause inflationary effects. Despite this fact, there is still a false belief in developing countries that consumption growth might be prevented by raising tax rates and consequently savings would increase.

Low income-individuals spend most of their income to meet their essential needs, therefore, when the prices of goods and services they need for their health or life go up due to tax hikes, they do not stop consuming; instead, they spend their already poor, hard-earned savings.

This is important in terms of correctly understanding the cause of the constantly declining savings rates despite the very high growth rates in developing countries.

The fact is that "dissuading people from excessive consumption", which is one of the main objectives of taxation, actually leads people, mostly in developing countries, to become more and more unwilling to quit buying non-essentials.

In some cases, spending increases so significantly that it even pushes prices upwards. Well, this effect can be tolerated for a while, because it is aimed to increase the government's tax revenue.

However, the negative effects arising out of people's growing tendency to stop setting money aside, which may cause important problems in the future, should not be underestimated.

Savings may shrink further due to the negative effects of growing consumption on the general level of prices

It would be an inaccurate approach to investigate the decline in personal or corporate savings due to high taxes only in terms of decrease in capital accumulation and number of investments.

It is also important where the government spends the taxpayers 'money. Against all expectations, savings may shrink further due to the negative effects of growing consumption on the general level of prices.

Today, most economies in the world agree that the most reliable resource for sustainable growth is domestic savings.

Accordingly, it is necessary to increase disposable income first in order to increase savings. Doing this will ensure not only greater amounts of savings but also a healthy level of consumption that supports economic growth.

However, the governments of developing countries tend to dislike things that take a long time to happen.

The savings to GDP ratio in developing countries is dramatically low when compared with developed countries.

This substantial savings gap causes both households and the private sector to resort to continuous borrowing.

For this reason, domestic credit growth in developing countries is much higher than their economic growth rates. Just like when your tyres are spinning but the car is not moving even though you hit the gas pedal.

> Without savings, there is no pressure to cut rates, which means there is no incentive for businesses to invest

What I have told confirms Keynes' theory that no savings results in no investment. Without savings, there is no pressure to cut rates, which means there is no incentive for businesses to invest.

Developing countries will not be able to avoid “growth through current account deficit“ as long as where the balance between domestic savings and investments are not established.

Government spending can be considered to be among the factors that ensure economic growth.

However, a quantitative growth in government spending is not sufficient for the development of an economy. The qualitative and effective nature of this spending as well as its financing method are equally important.

Although financing government spending, which plays a major part in the growth performance of developing countries, through taxes rather than borrowing, looks like the right thing to do at first glance, it could lead to a high cost of living and poverty in countries suffering from a savings gap.

For this reason, it would be wise to restore a strong balance between borrowing and tax revenue in public finance.

In conclusion, it does not seem possible to eliminate the savings gap experienced as a result of the continuous expansion of the government without a major change to the current growth model.

However, mostly caused by the outcomes of the pandemic and the Russo-Ukrainian war, this expansion is likely to continue not only in Turkey, but also in other countries, no matter which party or leader comes to power.