

Political Influence on Creating of Saving-Investment Gap in Transition Countries

By Damir PIPLICA [†]

Abstract. Governments of transition countries should become aware of the importance of implementation of such an economic policy that would encourage higher saving rates and at the same time bringing it in accordance with investment rates in order to achieve other important macroeconomic goals, without jeopardizing macroeconomic stability of their respective economies. Transition countries EU members have not conducted such an economic policy, which resulted in existence of a substantial difference between total investments and gross national savings in their countries. Although the influence of saving on investments was significant, conducting of economic (investment) policy of the right-wing governments of the transition countries EU members has more influenced imbalance of saving and investment in comparison to the left-wing governments. Should the right-wing governments, in applying of economic measures that stimulate higher investment rate than previous, follow their ideological point of view instead of turning to 'middle' voters, they would have an easier position in reducing saving-investment gap and in achieving macroeconomic stability in comparison to the left-wing governments. However, should the right-wing governments turn more opportunistically to 'middle' voters, instead following their ideological programme, that would make their position difficult in reducing saving-investment gap, because influence of saving to investment would be significantly lesser. Increasing of saving rate with left-wing governments would have significantly weaker influence on balancing of saving and investment in comparison to the right-wing governments, but their opportunistically turning to 'middle' voters would create slightly better position in realizing of macroeconomic stability, because by this their influence on reducing saving-investment gap would be improved compared to the situation when they would follow their left-oriented party programme.

Keywords. Saving, Investment, Political parties, Transition countries, Economic policy.

JEL. E2, H1, P2.

1. Introduction

In last 25 years, political systems of the ex-socialist countries have been, with more or less success, transformed in modern market economies. Such a specific environment, unique in its history, has created conditions in which some economic phenomena can behave differently in comparison to conditions that exist in developed market economies. Although in eleven observed countries, EU members, transition process is at the very end, there are still numerous differences in comparison to other countries EU members. At the same time, similarity of their transition processes has created certain specific qualities in relation to other

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transition countries, which are not yet EU members and which are significantly belated in the process of joining EU.

Economic development of transition countries EU members is still at lower level compared to developed West-European countries, therefore a special importance in conducting of their economic policy should be given to the growth of investment rate in order to increase GDP, employment rate, standard of the citizens, and the like. Lack of their own means for starting up new investments, eagerness to achieve desired results, no comprehension of economic rules, and other reasons can influence political governing elites to enter the investment activities significantly above their objective possibilities, and consequently we can have creation of macroeconomic imbalance with a negative effect on certain economies. This is exactly why we put creation of saving-investment gap in the very centre of our research, all in frame of specific transition environment, depending if right- or left-wing governments are ruling the country at the moment. Political goals of left- or right-wing governments can be important factor that would influence creating of larger or smaller saving-investment gap in the observed countries.

Results of the research would add to existing theoretic knowledge that has its source in Keynes' considerations of relation between saving and investments in market economy. Moreover, such existing conceptions would be updated by including ideological and opportunistic models that explain implementing of economic policy with left- and right-wing governments. At the same time obtained results can serve to the governments of the transition countries, that when setting the goals of their economic policy they have to take into consideration specific quality of their own political influence on creating of the saving-investment gap, and that, accordingly, realization of the set goals would be easier or more difficult. Disregarding of such specific influence of the governments of transition countries, depending on the fact if they are left- or right-wing, can cause failure of the bearers of the executive authority in achieving of desired economic goals.

2. Theoretical Research Basis

2.1. Theoretical points of view and empiric research related to creation of saving-investment gap – brief literature overview

Each saving in its basis means voluntary keeping of material goods or money from less useful spending at present, and at the same time postponing or restriction of spending for some future time, in order to be able to spend more in that future time. The Keynesian (1936) theoretic conception assumed the statement that saving is the difference between income and consumption evidenced for the period of time. Consequently, the investments represent expenditures spent for the period of time for some other benefits than the procurement of consumption goods. Keynes presumes that investments are an independent variable, and equilibrium between savings and investments is a condition of general macroeconomic stability, at a total range of potential levels of output and income, only one of which is full employment. Solow (1956) and the other, in their neoclassical models of growth in closed economies, considered that there was direct relation between rate of domestic savings and economic growth. Such correlation would not exist in open economies where foreign savings successfully replaces the role of domestic savings in financing of domestic capital.

Feldstein & Horioka (1980) have established positive connection of domestic savings and investments when there is no perfect replacement of domestic with foreign-savings. Moreover, Feldstein (1983), in his further researches has established on example of 17 countries in the period 1974-1979 that each extra

dollar of domestic saving increases domestic investment by approximately 85 cents. Obstfeld & Rogoff, (1997) consider that in the end interest rate on the global level would align total savings with total investments. Schneider (1999) has, by using inter temporal equilibrium model, shown that countries under development have lower correlation of savings and investments when compared to developed countries. Blanchard & Giavazzi (2002) have established, that within EU savings and investments are more and more separated, whereas less developed countries of EU have been saving less while investing more, while more developed EU countries have behaved to the contrary. Such processes have resulted in bigger deficits on current account of the less developed countries. De Wet & Van Eyden (2005) have established that in Sub-Saharan African countries rate of investments are influenced by foreign aid and foreign direct investments.

On the other hand Afzal (2007) have been researching connection of savings and investments in developing countries and has established that in seven observed countries there has been no long term correlation, which implicated increased grade of the mobility of capital across these countries. The author has also established that there was two-way mutual cause-effect connection between savings and investments in Southern Africa, but also that there was no connection between savings and investments in India, Philippines, Malaysia and Iran. Aizenman et al. (2007) have calculated cumulative saving-investment gaps for the period of 1993-2010, and have showed that the growth of domestic saving in financing domestic capital results in successful countries' growth. The authors consider that countries with low- or middle-level of income, but with lower share of foreign savings in financing of domestic capital, in the end have bigger economic growth, than the countries with bigger share of foreign savings. Prasad et al. (2007) have concluded that less- or middle-developed countries that do not significantly rely on foreign savings in financing of domestic capital, grow faster when compared to countries that rely on foreign saving sources. Pavelescu (2009) has expanded methodology of research Feldstein-Horioka model by including foreign trade balances into the research of saving-investment gap.

Gebreyehu (2010) have researched cause-effect connection between saving and investment in Ethiopia, but has found no connection whatsoever between the two. Mishra et al (2010) have established that the relation between saving and investment is influenced by capital mobility, current account targeting, etc. Cyrille (2010) has shown that the coefficient of correlation of savings and investments in Sub-Saharan African countries is at the very low level. On the other hand, Sanjib & Joice (2011) have researched relation between saving and investments in U.S.A., UK, China and India and have established their significant connection. Significant connection of savings and investments has been also established by Onafowara et al (2011), at an example of six developed West-European countries.

Bahmani-Oskooee et al (2012) think that countries insufficient savings of their own for financing investments should search financing sources abroad, or their economic growth would be lesser. Adom & Elbahnasawy (2014) have established low rate of savings and big savings-investments gap in developing countries. The authors think that an efficient conducting of measures of economic policy should reduce saving-investment gap as a pre-condition of economic growth in their countries. Gjorgji et al (2015) found that government sector in more developed countries realizes permanent negative saving-investment gap that is entirely financed by the net savings of the private sector. However, in the countries of South-East Europe negative saving-investment gap of the government sector cannot be financed by savings of the private sector, because the latter also shows negative saving-investment gap.

2.2. Theoretical points of view and researches related to the ideological profile of the government – brief literature overview

Several authors have researched the influence of the political environment to conducting of the economic policy of certain countries. Nordhaus (1975) has considered that, regardless of their point of view, all politicians want to be in executive government that implicates their opportunistic behaviour. Considering the fact that 'fresh memory' of the voters remembers mostly recent events, government uses such 'short memory' and tries, by expansive policy before the elections, to create impression of prosperity, while the bill for negative consequences is to be paid only after elections, when restrictive policy has to be introduced. Several authors, such as Cukierman & Meltzer (1986), Rogoff (1990) and Persson & Tabellini (1990) and others, have included elements of rational expectations in Nordhaus' theory. They have considered that voters do not have information on the level of politician's ability, and that there are asymmetric information between voters and bearers of the economic policy. Of course, some other authors also researched opportunistic models, such as MacRae (1977), Tufte (1978) and Keech (1995), etc. and they have explained the influence of the governing party on economic policy in the pre-election period, in order to enlarge its popularity among voters and to obtain new mandate.

On the other hand followers of the partisan theory are of the opinion that because of its ideological point of view, politicians want to achieve election victory in order to achieve certain economic aims that are in the scope of interest of the social groups that they represent, i.e., that have chosen them. Starting point of Hibbs' model (1977) is Philips curve, whereas left-wing parties when governing are more interested in increasing of employment rate and economic growth than in reducing of inflation rate, which is opposite with right-wing parties. Therefore, election success of left- or right-wing parties would mean that above mentioned policies are to be conducted accordingly.

Several other authors have established similar differences in conducting of economic policy, depending if governmental mandate has been given to left- or right-wing parties. Minford (1988) has established that right-wing parties are more averse to the growth of the inflation in comparison to the left-wing parties, because of the preservation of the real property value that is in possession of the higher middle class. Alesina (1987) has concluded that uncertainty of the election success and existing ideological difference between left- and right-wing parties would influence creation of business cycles. Some other authors, such as Chappel & Keech (1988), Alesina & Roubini (1992) and the others, have come to the same conclusion, and in addition they have established that sudden inflation or deflation changes can have economic effects, but they are of temporary character, due to adjustment to the post-electoral surprise. If there is a stronger political polarization between right- and left-wing governments, there would be a bigger deviation of income level around natural level, whereas getting back to the natural level would come following year.

By using of the above mentioned theoretical consideration several researches have been conducted in transition countries, some of which we have pointed out in the context of our research. Thus, Halleberg & de Souza (2000) have established existence of political-business cycles in the era of admittance of some transition countries to EU. Akhmedov & Zhuravskaya (2004) have established that state expenditures in Russia start to grow nine months prior to elections, and falling down after the elections. Klačnja (2008) has come to quite similar results, whereas he has established that in the period after the elections there are no measures that

could annul pre-election expansion. Maurel (2006) has concluded that there are essential fiscal changes in election times in certain members of EU.

3. Applied Model and Methods of Research

In our model of research we shall start from the basic hypothesis that the condition of macroeconomic equilibrium of an economy is equality of national savings and investments, i.e. $S=I$, in the long run. It is wrong to observe this equality as a given state, it should be observed as a dynamic process. All modern economies today are, of course, open and international trade makes more or less important part of their GDPs. However, we start from the presumption that only equilibrium of savings and investments enables macroeconomic balance of a national economy, i.e. that their imbalance results in certain form of macroeconomic destabilization. Due to low level of GDP, less developed countries are not in position to dispose with such a level of savings that would create means essential for financing of investments, so they often try to achieve economic growth above realistic possibilities which results in negative consequences to domestic economy.

We shall include following categories in our research: total investments and gross national savings, for observed transition countries. We think that investment activity of the governments of transition countries largely depends on political influence of the governing parties. Therefore, in our research we shall consider behaviour of the governments of the observed transition countries, depending of the fact if they are of left- or right-point of view, which should adequately reflect on their conducting of economic policy. We added the data on saving and investment to appertaining years depending on the fact whether left or right-wing parties were in power.

Our basic hypothesis is that there is essential difference between total investments and gross national savings in transition countries members of EU. We shall also additionally check if, because its point of view (ideological) economic policy of left-wing governments compared to economic policy of right-wing governments result in different relation between savings and investments aimed to achieve certain economic goals (economic growth, increase of employment rate, raise of living standard, etc.), which, consequently results in differences of macroeconomic stability of transition countries. Obtained results are statistically processed according to the regulations of the model applied.

Our research comprises following countries: Lithuania, Latvia, Estonia, Poland, Czech Republic, Slovakia, Slovenia, Hungary, Bulgaria, Romania and Croatia, all in the period 1991. – 2013. Observed transition countries have several election cyclises after democratic changes which represent sufficient substance for the research results.

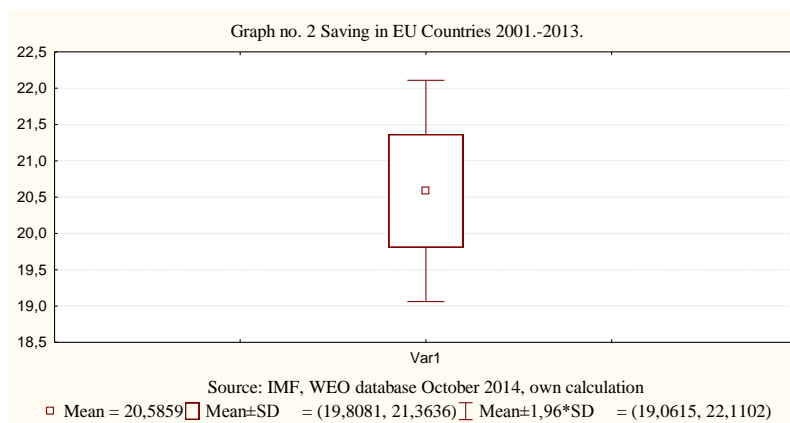
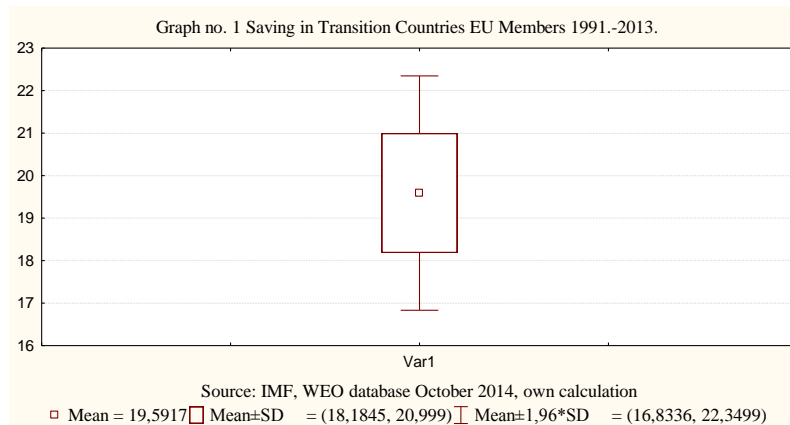
4. Data, Estimation and Results

4.1. Transition Countries and EU

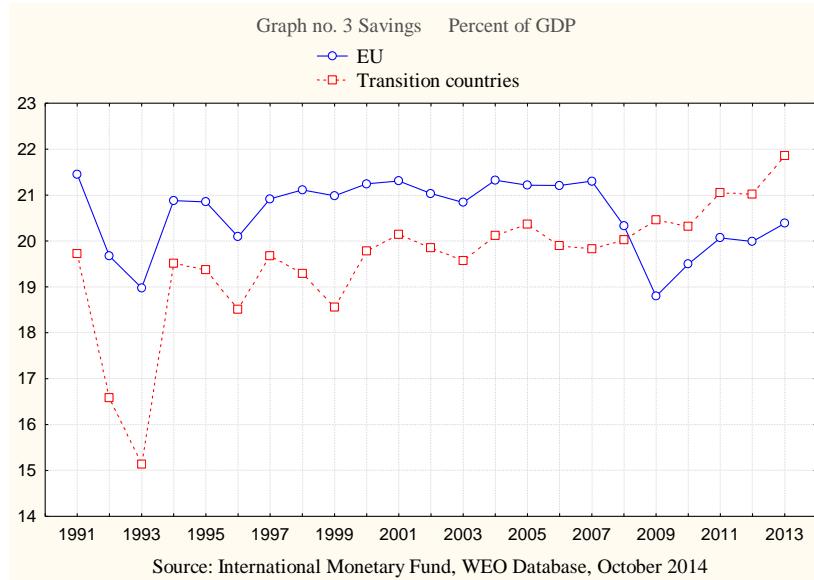
When analysing data for the observed period, related to saving- and investment-rates in transition countries EU members compared to the data for all today's EU members, certain differences would be obvious. If we first consider data for average savings rate in today's transition countries EU members by year, and in the period 1993 – 2013, it will be obvious that they varied in range of 15.13% - 21.86%. However, lower saving rates were characteristic of relatively distant 1992 and 1993, in order to have an average savings rate in transition countries in later period mostly between 19%-20%. Furthermore, average saving-rate in the observed period for all today's EU members was higher for 1 percent point when

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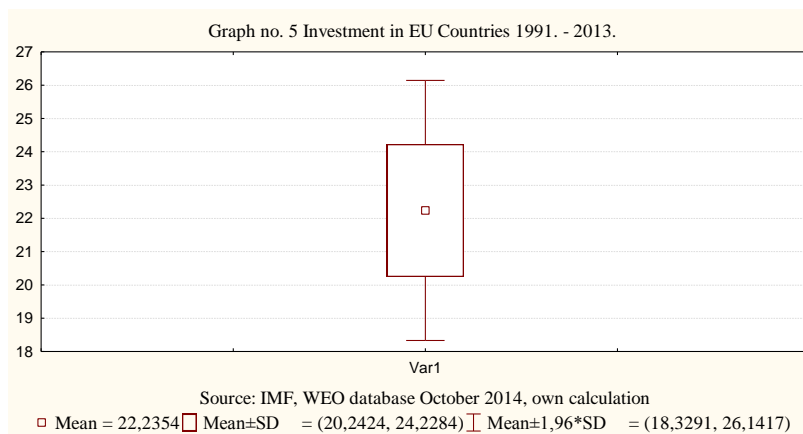
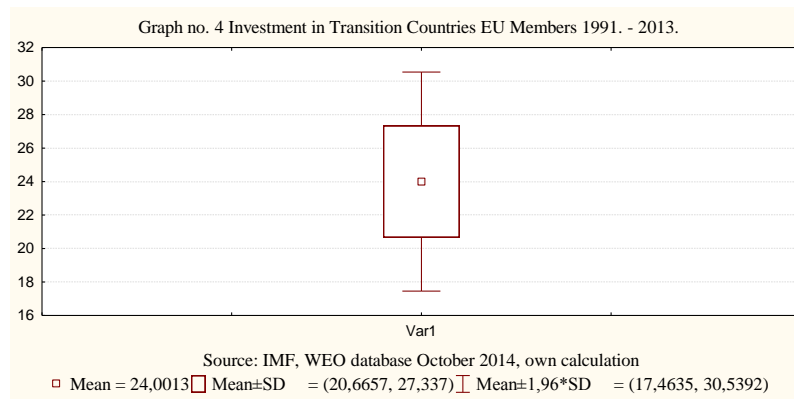
compared to average savings rate in the observed transition countries, and it amounted 20.59%. On the other hand, average saving rates by year for all the today's members of EU were in slightly lower range, amounting between 17.79% and 21.45%. Standard deviation for the mentioned saving rates in transition countries amounted 4.42 that was less compared to all today's EU members, where it was 5.24, so they represent somehow more homogenous distribution of values. Therefore indicators of the observed transition countries showed dispersion of 23%, which is less in comparison to dispersion of all indicators for all today's EU members, because their coefficient of variation amounted 25.52%. Observed differences are obvious from the following graphs No. 1 and 2.



Graph No. 3 clearly shows comparison of the saving rates in today's transition countries EU members with saving rates of all today's EU members for the period 1991-2013. It is obvious that other EU members have continuously higher saving rates in the period 1991-2008, than transition countries. Only since 2008 saving rates in transition countries have been increased above the rate of all EU members, which is exactly one of the essential factors of reducing of the differences among EU member's countries.

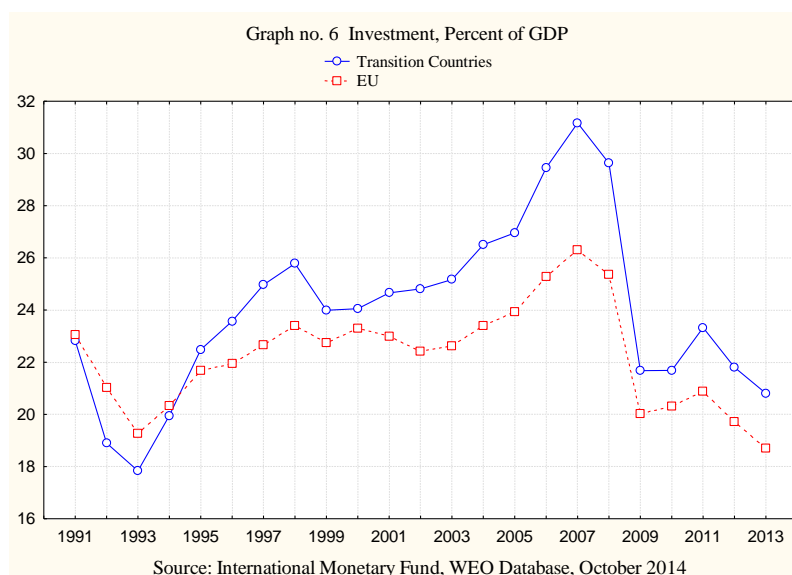


Despite the fact that in the largest part of the observed period saving rates of the transition countries have been behind compared to other EU members, investment rate was higher and on average it amounted 24%, while average investment rates in all today's EU members amounted 22.24% which is best represented in graphs No. 4 and 5. Moreover, average investment rates in transition countries was unstable and varied more compared to other EU member countries, and it was moving in the range of 17.84% till 31.17%, while average investment rates in all today's EU countries was more stable and moved between 18.71% and 26.31%.



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Graph No. 6 clearly shows us that transition countries, apart for the several starting years, in the whole observed period have had significantly higher investment rate than the EU average. Even after 2009, when average investment rate was significantly downsized, transition countries again have invested more than the rest of EU. This, of course, would be very good if there were an accordance of investments with disposable savings, which was not the case.



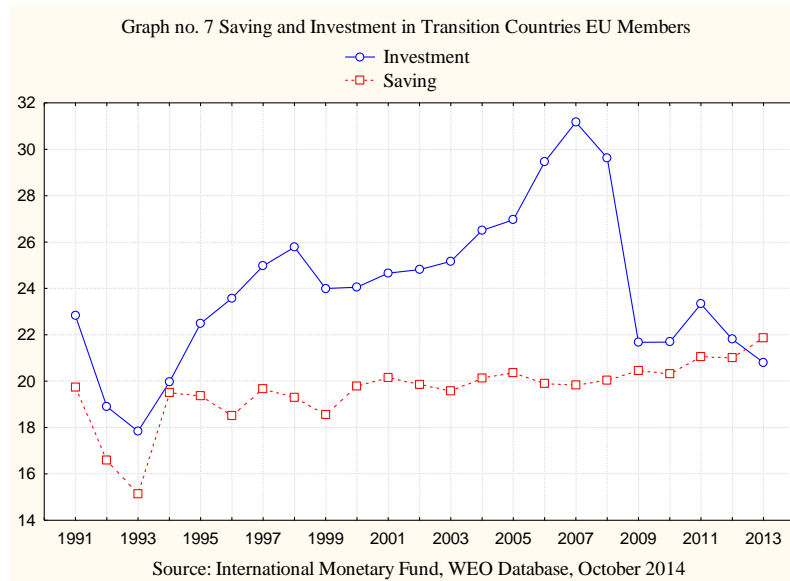
If we presume that disposable saving and investments are two sides of a coin, than we can conveniently test our null hypothesis. The dependent t-test is testing our null hypothesis that there are no differences between the data of the two connected groups ($H_0: \mu_1 = \mu_2$). In our case we would test our null hypothesis that there are no significant differences between investments and savings in observed transition countries. If we get a significant result, we can reject the null hypothesis that there are no significant differences between the data and confirm the alternative hypothesis that there are statistically significant differences between the data. In our research 242 cases in the period 1993-2013 have been included, regardless of the fact if left- or right-wing governments were in power in today's transition countries.

Table 1. Transition Countries EU Members 1991.-2013.

T-test for Dependent Samples - Investment (marked differences are significant at $p < 0.0500$)								
	Mean	Std.Dv.	N	Diff.	Std.Dv. - Diff.	t	df	p
Saving	19.6864	4.4268						
Invest-ment	24.3562	5.6509	242	-4.6698	5.1638	-14.0682	241	0,0

Source: IMF, WEO Database October 2014, Own Calculation

The dependent t-test has shown that there are significant deviations t_{calc} when compared to t_{crit} so we dismissed our null hypothesis that there were no significant differences between two observed groups of data, meaning that there were significant deviation in levels of savings in transition countries EU. At the same time, this means that forcing of investments above realistic possibilities influenced macroeconomic imbalance of the observed countries. The above is also obvious from the graph No. 7.

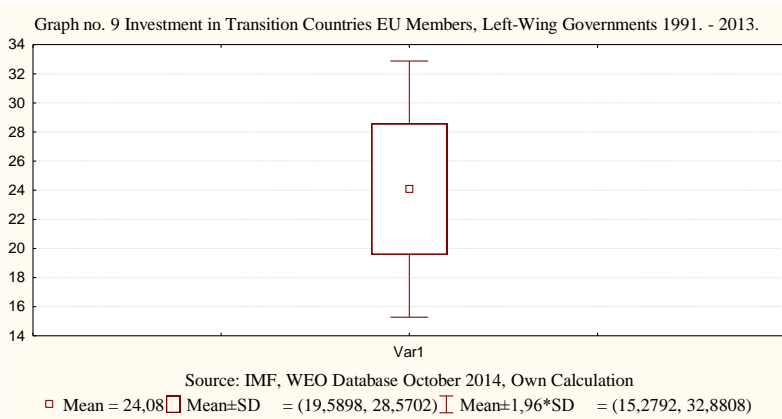
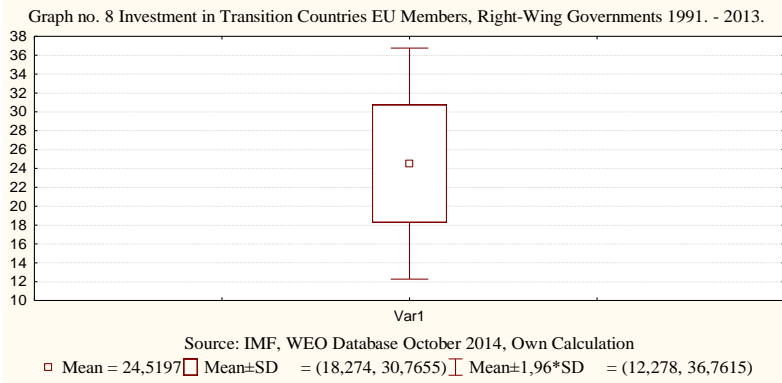


Data that have been analyzed so far points out on a significant saving-investment gap in the observed transition countries, which is obvious from the previous graph. Practically in the whole observed period there is significantly higher investment in transition countries in relation to disposable saving, that influences creation of macroeconomic imbalance in their economies. This has especially culminated in 2007, and thereafter comes a phase of 'sobering' in conducting of economic policy, by realization that there cannot be investment above realistic possibilities, without economic consequences.

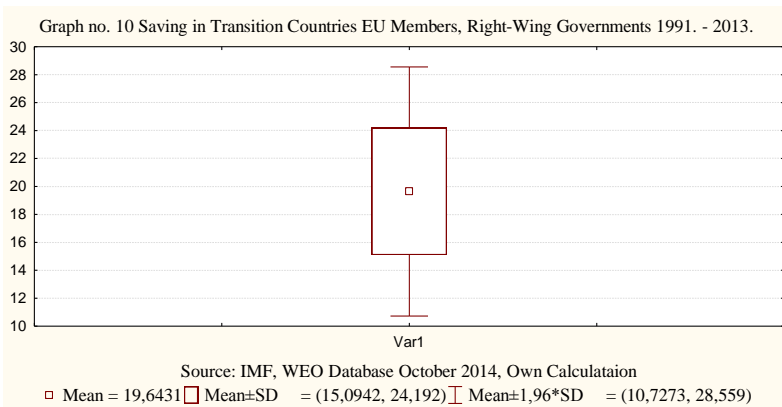
It is also evident that transition countries contribute to macroeconomic imbalance of EU as a whole that would request taking specific economic measures of the creators of the economic policy in order to eliminate such imbalances in certain countries. In that sense, bearers of political and economical power in EU must have more sensitivity toward transition countries in order to more easily prevail created macroeconomic imbalances, reducing them instead of making them even deeper.

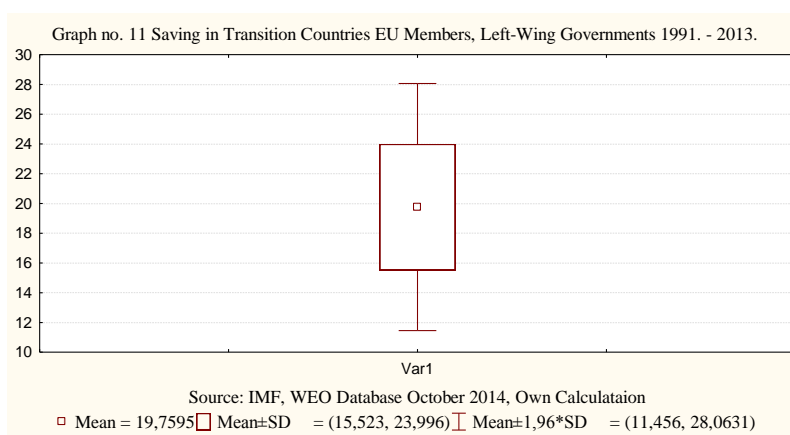
4.2. Transition Countries EU Members and Their Governments' Political Point of View

When, in scope of the observed transitional environment, we consider certain governments, depending of the fact if they are of left- or right- point of view, we shall have interesting data that relate to creating of the saving-investment gap. Right-wing governments in the observed period have had more political success and have been more present in authorities than left-wing governments, so we'll have their data for 152 of the observed cases, while data for left-wing governments are available for 90 cases only. It is interested that the right-wing governments have had an average investment rate of 24.52%, which is slightly higher compared to left-wing governments that have had an average investment rate of 24.08%. Range of the investment rate was similar, so right-wing governments have had the lowest investment rate of 10% and even up to 40%, while with left-wing governments it was in the range of 8.3% up to 37.5%. However, standard deviation of the right-wing governments was 6.25, while with the left-wing governments it was 4.49, meaning that they have had less homogenous distribution of their values. The above said can clearly be seen from the graphs No. 8 and 9.

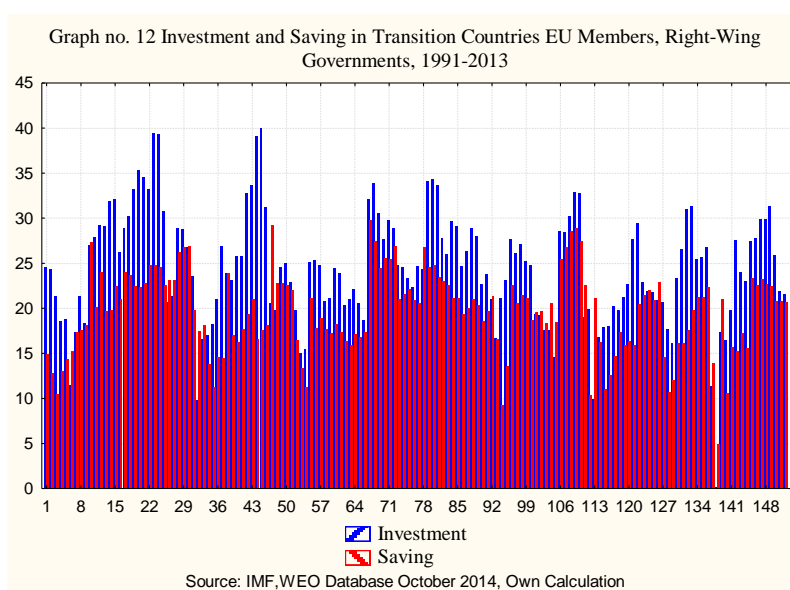


On the other hand, an average saving rate of the right-wing governments in the observed period amounted 19.64%, which is very like average saving rate of the left-wing governments of 19.76%, therefore we can conclude that there was bigger disproportion between saving and investment with right-wing governments in comparison to left-wing governments. However, mutual connection of savings and investments with left- and right-wing governments is somehow different, which will be seen from the following analysis. Minimum saving rate with right-wing governments was 4.95%, while maximum saving rate was 29.76, while with left-wing governments it ranged from 8.89% up to 26.6%. Standard deviation of right-wing governments amounted 4.55%, and of left-wing governments it was 4.24%, meaning that left-wing governments have had more homogenous distribution of the values. The above stated can be seen from the graph No. 10 and 11.





By observing dynamic relation between savings and investments of right-wing governments, it is obvious that their relation is not sufficiently balanced, which can be clearly seen from the graph No. 12. In certain cases these deviations in favour of investment can have more than double difference (Latvia case in 2007, when investment rate was 40%, while saving rate was only 17.6%). However in longer part of the observed period, relation of investment rate and saving rate was mostly on a 'steadily' higher level.



By further statistical analysis of the data obtained, we have established significant relation of the investment rate and saving rate of the right-wing governments, although their correlation could be on a slightly higher level (table No. 2). It is obvious that the investment rate in the whole observed period is significantly above the saving rate in some countries, so the resulting difference have to be covered from some other sources. However, conducting of the economic (investment) policy of the right-wing governments of the observed transition countries have had less effect on macroeconomic imbalance compared to the left-wing governments. On the other hand, should right-wing governments in applying economic measures rise saving rate on a higher level, and at the same time followed their ideological point of view, and less opportunistically turning towards middle voters, they would be more efficient in balancing saving and investment

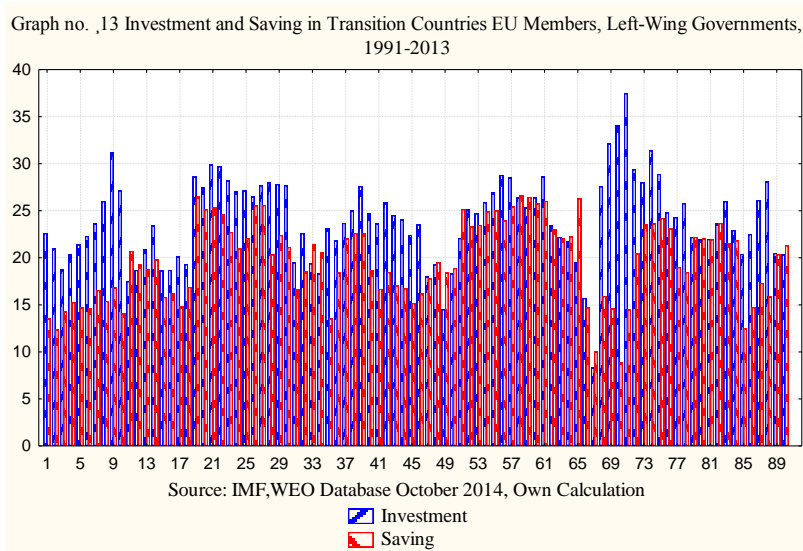
and achieving macroeconomic stability in comparison to the left—wing governments. However, should right-wing governments turn more opportunistically to 'middle voters' instead of following their ideological programme that would make their position in reducing of saving-investment gap more difficult, because influence of the saving to the investment would be significantly reduced. The above fact can be especially interesting in pre-election time, when political parties of left- or right-orientation, turn more to 'middle' voters in order to obtain more votes and win the elections.

Table 2. Investment and Saving – Right wing Governments in Transition Countries EU Members 1991-2013

Dependent: Investment	R = 0.58602707	F = 78.45924
R2= 0.34342772	df = 1.150	
No. of cases: 152 adjusted	R2= 0.33905058	p = 0.0000
Stand. error of estimate: 5.077737848	Intercept: 8.714250883	
Std.Error: 1.831288	t(150) = 4.7585	p = 0.0000
	Var2 beta = 0.586	

Source: IMF, WEO Database October 2014, Own Calculation

When observing dynamic relation of saving and investment with left-wing governments of transition countries EU members, it would be evident that their relation was also imbalanced, but slightly less than with right-wing governments, which can clearly be seen from graph No.13. In certain cases these deviations in favour of investments can be four time higher (the case of Bulgaria from 2007, when investment rate was 34.1%, while saving rate was only 8.9%) Graph No. 13 also clearly shows that in longer part of the period relation of the investment rate to saving rate was mostly on a higher level, whereas resulting gap considerably varied.



By further statistical analysis of the obtained data we have established slight connection between investment rate and saving rate of the left-wing governments and it would be better if their correlation is on a higher level (table No. 3) In certain cases investment rate was significantly above the saving rate of certain countries, because their governments obviously tried to catch up delay in economic growth and growth of the country in shorter period of time. Conducting of economic

(investment) policy of the left-wing Croatian governments necessarily asks for lifting up the saving rate on a higher level, but still its conduction will be less effective compared to right-wing governments.

Table 3. *Investment and Saving – Left wing Governments in Transition Countries EU Members 1991-2013*

Dependent: Var1	R = 0.28644781	F = 7.866034
R2= 0.08205235	df = 1.88	
No. of cases: 90	adjusted R2= 0.07162113	p = 0.006198
Stand.error of estimate: 4.326410613	Intercept: 18.08098492	
Std.Error: 2.187033	t(88) = 8.2674	p = 0.0000
	Var2 beta= 0.286	

Source: IMF, WEO Database October 2014, Own Calculation

On the other hand, efforts to increase saving rate of the left-wing governments that would strictly follow their ideological programme, would have more difficulties with increasing of the saving-investment gap than right-wing governments, but their opportunistic turning to 'middle' voters would create them slightly easier position in achieving macroeconomic stability, because in this way their influence on reducing of saving-investment gap would be stronger. This fact can be especially interesting to creators of the economic policy of left-wing parties in pre-election time, when they can turn more to middle voters in order to get more votes and at the same time influence reducing of the saving-investment gap.

5. Conclusion

Transition countries EU members after transition to market conditions in economy did not have relation of disposable savings and investments in accordance. Desire to have faster economic growth in relation to actually disposable savings created large saving-investment gap and macroeconomic imbalance in their economies. Although in implementing of economic (investment) policy of the right-wing governments of the transition countries the influence of the saving to the investment was significant, it still encouraged more creating of the saving-investment gap than with left wing governments.

Should the right-wing governments in conducting of the measures of the economic policy increase saving rate on a higher level and at the same time followed their political profile and turned less towards 'middle' voters, they would have had easier position in reducing saving-investment gap, and achieving macroeconomic balance too. However, should right-wing governments turned more opportunistically to middle voters instead of following their ideological programme that would make their position in reducing saving investment gap more difficult, while influence of saving to investment would be significantly weaker. On the other hand, should left-wing governments succeeded to increase saving rate on a higher level, but persist in their ideological profile in implementing measures of the economic (investment) policy, they would have many more difficulties in reducing of saving-investment gap, than when opportunistic turning towards 'middle' voters.

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