

Global imbalances and the paradox of thrift

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Oxford Review of Economic Policy, Volume 28, Issue 3, AUTUMN 2012, Pages 431–443, <https://doi.org/10.1093/oxrep/grs027>

Published: 29 September 2012

Abstract

This paper analyses the relationship between the global imbalances and the financial crisis. The imbalances were connected with the increase in world savings emanating from the ‘savings glut’ countries, notably China. This increase in savings led to a decline in world interest rates, and thus to greater borrowing, especially in the United States. This borrowing was for financing consumption, wars, and *unwise* rather than *fruitful* investment, especially in housing. The failure to invest in fruitful investments led to the financial crisis, and thus the decline in US and world-wide aggregate demand. This was the *indirect paradox of thrift*. It is to be contrasted with Keynes’s paradox of thrift, where the decline in aggregate demand and output would have resulted directly from the rise in world savings. The paper also discusses why there was not more borrowing for fruitful investment, especially in developing countries, hence avoiding the financial crisis.

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JEL: F32 - Current Account Adjustment; Short-Term Capital Movements, F34 - International Lending and Debt Problems, F4 - Macroeconomic Aspects of International Trade and Finance

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