Saving might be a virtue for people, but it is a vice for economies

Fabian Lindner of the German macro-economic research institute IMK has submitted a very timely and well-argued piece to the World Economic Reviw: "Does Saving Increase the Supply of Credit? A Critique of Loanable Funds Theory". He takes on influential theses of luminaries from Larry Summers, over Ben Bernanke to Hans-Werner Sinn by tracing them back to the loanable-funds-fallacy - a fallacy which still rules standard textbooks. His main proposition is simple and not refutable: firms and economies do not operate at full capacity. All research and surveys show that

industrial capacities usually have a utilization rate of around 80%. Labor capacities are hardly ever fully utilized, either. Mass unemployment and underemployment are the norm.

This simple fact combined with the fact that we live in an economy with fiat money destroys the savings-glut theses that Summers and Bernanke have proposed in different variants, as well as the claim by Sinn that capital exports from Germany to peripheral Eurozone countries have depressed German growth before the crisis and that now the opposite is happening.

These theses rest on the loanable-funds-idea that there is a pool of resources available for investment, which is determined by the amount of savings. However, this would only be true if production capacities were fully utilized. In this case, production capacities for investment goods would only become available if somebody reduced their consumption first, i.e. saved more.

With large buffers of production capacity, there is no need to save first. More investment goods can be produced without cutting back the production of consumer goods. All what is needed is banks financing this additional investment by increasing the amount of credit provided. More investment will produce more income, which will make sure ex-post that savings increase and the savings-investment-identity is obeyed.

This is much more than a theoretical point. The loanable funds fallacy is responsible for many errors in economic policy. It implies that more saving is normally good for long-term growth, because it is a requirement for more investment. In truth, more saving often means even lower capacity utilization than normal and thus less investment and less income.