WP/92/91

INTERNATIONAL MONETARY FUND

Research Department

The Savings Trap and Economic Take-off

Prepared by Carlos M. Asilis* and Atish R. Ghosh*

Authorized for distribution by Malcolm Knight

November 1992

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Abstract

We develop an overlapping generations model of a developing economy in which 'culture' and technology interact to determine savings, investment and growth. Investment is assumed to involve intermediation or other costs which may, in each period, result in either of two stable equilibria for the savings rate. At the "good" equilibrium, savings and growth are higher than at the "bad" equilibrium. Whether the country attains the good or bad equilibrium in any period depends on each individual's belief about the savings behavior of other agents in the economy. The model implies that fiscal policy or public activities to facilitate private investment can influence saving. In particular, a sustained period of fiscal restraint can shift the economy onto a higher savings and growth path.

JEL Classification Nos.

D50, D91, H30

*International Monetary Fund and Princeton University, respectively. The views expressed herein do not necessarily reflect those of the institutions with which the authors are affiliated. We would like to thank William Branson, Willem Buiter, Malcolm Knight, and Masao Ogaki for useful discussions and comments.

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