

**THE UNIVERSITY OF THE WESTERN CAPE
DEPARTMENT OF ECONOMICS**

**AN INVESTIGATIVE ANALYSIS INTO THE SAVING
BEHAVIOUR OF POOR HOUSEHOLDS IN DEVELOPING
COUNTRIES: with specific reference to South Africa**



**Research Report prepared in partial fulfilment of the requirement for the degree
of Masters in Economics**

Supervisor: Elizabeth Stoltz

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ABSTRACT

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In South Africa, as in many developing countries, most households are poor and do not save, as a result of which they do not acquire any positive net worth and which also constrains access to formal means of finance. South African is a consuming nation, with increasing ratios of household consumption resulting in dissaving and often unsustainable levels of household debt, which is also stimulated by the current lower level of interest rates. This situation is worse amongst poor households who also often experience financial shocks, for instance because of the death of family members as a result of HIV/Aids. Empirical evidence in South Africa indicates that some of these households do try to save, but that it is extremely difficult to escape from the vicious circle of overspending and debt.

The report provides an overview of household saving in South Africa for the period 1983 to 2003. It identifies the main factors responsible for the lack of a commitment to saving which are particularly relevant in the case of poor households. The main factors are: lack of income (due to unemployment), insufficient income, over-consumption (due to conspicuous consumption, procedural rationality and the bandwagon effect) and market failures, such as incomplete or even no information, lack of financial literacy, cultural and political factors. What is also alarming is that more than a decade after democracy, poor households in South African still prefer informal savings institutions. Suggestions are made to build bridges between formal and informal financial institutions in South Africa.

A comparison is presented between the success stories of China, Singapore and Malaysia and factors are identified that should be taken into consideration by policy makers in South Africa. It is clear that the government should take on a stronger role in this regard and be committed to the creation of a culture of saving, particularly in the case of poor households in an effort to rule out poverty in South Africa.

DECLARATION

I declare that *An Investigative Analysis into the Saving Behaviour of Poor Households in Developing Countries: with specific reference to South Africa* is my own work that has not been submitted before for any degree or examination at any other university, and all the sources I have used or quoted have been indicated and acknowledged as complete references.

Marie-Therese Nga



January 2007

Signed:.....

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ABBREVIATIONS

ABET: Adult Basic Education Training

ASCAs: Accumulating Savings and Credits Associations

CPF: Central Provident Fund

EPF: Employee Provident Fund

GDP: Gross Domestic Product

GNP: Gross National Product

HPAE's: High Performing Asian Economies

LCH: Life – Cycle Hypothesis

NASASA: National Stokvel Association of South Africa

NABSSA: National Association of Burial Societies of South Africa

NGO's: Non-Government Organizations

NHFC: National Housing Finance Corporation

PIH: Permanent Income Hypothesis

ROSCAs: Rotating Savings and Credit Associations

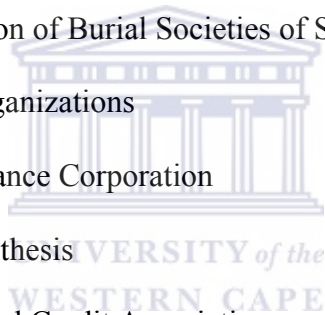
SACCO: Savings and Credit Cooperative / Credit Union

SASI: South African Saving Institute

SARB: South Africa Reserve Bank

UCT: University of Cape-Town

WTO: World Trade Organization



CHAPTER ONE

INTRODUCTION

1.1 STATEMENT OF THE PROBLEM

Sufficient national saving provides an economy with enormous benefits. A country with a high savings rate could generate both foreign and domestic investments and need not depend on foreign debt. The financial sector in every economy is responsible to put these savings back into the income and expenditure circular flow, through investment. Furthermore, Miles and Scott (2004: 72) commented that: “The more investment a country does, the higher its steady state standard of living.” It also seems as if saving and investments are more beneficial if they come from the domestic sector and more specifically from the household sector (Samuelson and Nordhaus, 1995: 445).

However, saving by individual households is important for the households themselves. It is a necessary condition to improve or maintain the quality of life of the members of the household. Certain household needs (such as more durable consumer goods) require relative large amounts of money, which ordinary households can never acquire, unless they save over an extended period of time. However, poor households who save too little or none characterizes the saving behaviour of households in developing countries at all. Even those who are in a position to save, often over-consume, thus dissave. As a result they do not acquire any positive net worth, which limits any access to formal finance.

This is also true in South Africa where the household saving ratio has declined substantially over the past two decades. According to the media it is the lowest since 1952 and this tendency has worsened in the recent past. It can be taken for granted that this low saving rate is worse among the low-income households (poor households). Due to poverty, unemployment, lack of education and information failures, low-income households have a limited saving capacity and are mostly not

financially literate. Even those who are financially literate may not trust the formal financial institutions because of the apartheid legacy of the past.

The decline in the saving ratio can be attributed to a number of factors such as more easily available credit resulting in people spending more and deferring payments, and a growing culture among the younger generation (even the middle class) to spend more and save less. Although various factors, such as conspicuous consumption, procedural rationality and bandwagon effects contribute to overspending and distort their saving decisions, there is evidence that they do want to save. However, due to market failure such as incomplete information adverse selection and financial illiteracy, these households lack a general 'culture of saving'.

This is partly explained by the fact that sophisticated financial institutions have failed to address the needs of the poor. The poorer segments of the population in South Africa were previously excluded from the services of the formal banking sector, due to the lack of surety (i.e. to secure a loan) and because financial institutions do not find it cost-effective to service small accounts.

Today, more than ten years after the first democratic elections, these households still prefer to use informal saving mechanisms (such as stokvels and burial societies) as a means to mobilise financial resources. Given the large volume of informal saving generated annually by these institutions, it is undoubtedly significant for the financial sector. In South African context, this raises an important question: Why do they continue to survive alongside a sophisticated formal sector? Although these groups continue to flourish, they carry several weaknesses and do not remove the need for formal financial services. Furthermore, over-indebtedness by these households often pushes them to fall victim to loans sharks.

Empirical evidence shows that this situation can be reversed. There are examples of countries where households at the beginning of the 20th century were just as poor as those in South Africa. These countries were successful in creating a 'culture of saving' amongst households. Although each country uses different policy approaches to solve the problem, common factors can be identified and lessons can be derived from it.

This financial situation of poor households in South Africa appears to be so alarming that an investigation into the determinants of their saving behaviour can make a valuable contribution towards a better understanding of this problem.

The goals of this paper are therefore:

- To identify the factors (according to economic theory) determining household saving in general.
- To discuss factors responsible of the lack of saving by households in developing countries.
- To provide an overview of household saving in South Africa for the period 1975 – 2005.
- To investigate the role and importance of informal saving institutions in South Africa.
- To compare and contrast the experiences of the East Asian countries with that of South Africa.
- To suggest strategies to create a savings culture that will improve the quality of life of poor households.

1.2 SIGNIFICANCE OF THE STUDY

This topic is of importance not only to advance our knowledge of the determinants of household saving amongst poor households in South Africa but to support the current debate on the effectiveness of saving incentives, on the role that institutions can play and on inclusive financial systems for all.

1.3 RESEARCH METHODOLOGY AND OUTLINE OF THE PAPER

The research method that was followed to compile this report is of a descriptive analytical nature. It includes an overview of the existing literature and it is both quantitative and qualitative. A qualitative analysis is used to interpret secondary data and a typology case study is presented. The evidence and statistical data have been obtained from sources like the South African Reserve Bank, the Financial Dairies Project, Statistics South Africa, The Economics Departments of the governments of Singapore and Malaysia, the World Bank and personal interviews (with a financial consultant and two poor households).

The paper is organized as follows: **Chapter two** provides a theoretical background of household saving as well as a discussion of the empirical evidence on experiences in developing countries. **Chapter three** summarizes the international experience on household saving. Three case studies of Singapore, Malaysia and China are presented to demonstrate these experiences. **Chapter four** focuses on the South African experience. It gives an overview of the saving behaviour of households in general and discusses the informal saving mechanisms as channels used by poor households to mobilize saving.

It also provides some suggestions to build bridges between formal and informal institutions and highlights the important role of government in this regard. Finally **Chapter five** presents a general conclusion.



CHAPTER TWO

THEORETICAL REVIEW AND EMPIRICAL EVIDENCE

2.1 INTRODUCTION

In order to provide a framework for the investigation carried out in this research report, this chapter presents an overview of the traditional theories that explain the saving behaviour of households. The chapter thereafter focuses on other factors that according to the literature were found to be particularly relevant regarding the saving behaviour of poor households in developing countries. The final section relates to the mobilisation of savings in developing countries.

Section 2.2 explains the relative importance of household savings and Section 2.3 presents the traditional theories of household savings. Section 2.4 explains the relevance of other factors and Section 2.5 provides an overview of saving mobilization in developing countries.

2.2 THE IMPORTANCE OF HOUSEHOLD SAVINGS IN A DEVELOPING ECONOMY

Households have varying needs of which some must be satisfied immediately (and this can be done from current income), but other needs will occur in the uncertain future, some of which are planned and some unforeseen. To satisfy this future needs money need to be saved to be available when needed? This means that households must sacrifice current consumption to be able to consume in the future.

Households need funds in future for various reasons, such as: durable consumer goods, a stove or a car; children's education; acquiring a home and healthcare; Education is usually high on the priority list of most households. Even if one can estimate school and university fees by compounding present fees at a realistic rate, government assistance might change drastically in 20 year's time, resulting in much higher fees than planned for. Acquiring an own home is another high household priority. Usually financial institutions tend to lower their risk by lending to loan applicants who have a track record at a financial institution and who can demonstrate commitment by paying a deposit. To have

money for the deposit, households need to save. Expenditure on healthcare has an erratic character and medical schemes offer relief to smooth out cash outflows. Membership of a medical scheme is therefore a necessary savings mechanism. Another often-neglected future requirement is to provide for retirement.

Poor households are in totally different situations. While ordinary households enjoy the luxury of permanent jobs that come with automatic savings mechanisms such as medical aid and retirement schemes or own their own successful enterprises that ensure adequate income to support savings for necessary and unnecessary future needs, poor households mostly cannot even pay for very necessary current consumer goods and services. Yet they also need to save for future needs. These needs can be normal everyday needs such to eat and pay for transport, but are often unforeseen, such as to pay for funeral costs. Often the breadwinners of these households work sporadically and need to save for when they are jobless. For them, saving is imperative. Poor households may want to free themselves from poverty and need to save to enable them to start some form of enterprise, for example, a mother who wants to buy a sewing machine to be able to earn an own income while taking care of small children at home. Furthermore, in South Africa many families have members who have been diagnosed with HIV and money needs to be set aside to take care of these people in the near future.

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2.3 THEORIES OF HOUSEHOLD SAVING

The theories discussed in this section attempt to explain how individuals save from their income. Commentary on the relevance of Keynesian's view for the present discussion is also provided at the beginning of this section. According to the literature, there are two major theoretical hypotheses explaining household saving behaviour, namely the permanent income and the life-cycle hypotheses.

2.3.1 Early Keynesian Theories on Savings

Some interesting and very extensive studies on saving behaviour of households owe its beginnings to the earlier Keynesian theory on the determinants of saving, which is referred to as the absolute income hypothesis.

Keynes's analysis followed the traditional theory of demand in which savings was viewed as a luxury good. The motive behind savings was the desire by the rich to bequeath an estate. Keynes as referred to by Modigliani (1986) identifies eight motives of saving, which are:

1. to build up a reserve against unforeseen contingencies;
2. to provide for an anticipated future relationship between the income and the needs of the individual;
3. to receive interest and capital appreciation;
4. to enjoy for gradually increasing level of expenditure;
5. to enjoy a sense of independence and the power to do things, though without a clear idea or definite intention of specific action;
6. to secure a masse de manoeuvre to carry out speculative or business projects;
7. to bequeath a fortune;
8. to satisfy pure greed, i.e., unreasonable but insistent inhibitions against acts of expenditure as such (avarice).

Keynes explained that income was the most systematic determinant of individual (household) saving. Individuals with a low income cannot save. That is why the Keynesian savings function in its most common form is linear with a constant marginal propensity to save (MPS).¹

$$\text{Therefore: } S = \alpha_0 + \alpha_1 YP \text{ -----(1)}$$

Where:

- S = gross domestic saving,
- YP = gross national product and
- α_1 = constant marginal propensity to save.

It is assumed that $\alpha_0 < 0$, and $0 < \alpha_1 < 1$, so that as the level of income rises, the average propensity to save will also increase (Mikesell and Zinser; 2001:3). It is important to note that equation (1) is the most popular version of the absolute income hypothesis. Also, Keynes, according to (Modigliani; 1986) predicted that the average propensity to save of the average household would increase when

¹ The marginal propensity to consume (MPS) is the increase in consumption with a unit increase in income.

they reach a higher income level. This contribution was an important source of inspiration for both the permanent income and the life-cycle hypothesis.

It is quite remarkable, however, that Browning and Lusardi (1996) in their research on household saving (more than half a century later, only added one more motive, i.e. the “down payment motive.” They remarked that these motives are important to consider for empirical estimation of saving functions. But this shows how accurate Keynes was in his observation of patterns of household saving.

2.3.2 Permanent-Income Hypothesis

Following on this innovative work by Keynes, Friedman (1957) postulated the Permanent-Income Hypothesis (PIH)².

2.3.2.1 The Theory

This hypothesis differentiates between permanent and transitory components of income as determinants of household saving.

- *Permanent income* is defined in terms of the long-term income expectations over a planned period and with a constant rate of consumption maintained over the lifetime given the present level of wealth (Muradoglu and Taskin: 1996). According to Samuelson and Nordhaus (1995: 430) permanent income is the level of income that households receive when temporary influences such as the weather or a windfall gain or loss are removed.
- *Transitory income* is the difference between actual and permanent income. Individuals are assumed not to consume from transitory income, therefore the marginal propensity to save from this income is one.

According to Rouseas (1972: 172), Friedman made a distinction between income and wealth. He claimed that income or permanent income is different from wealth. To him wealth is composed of non-human and human wealth and wealth is the source of permanent income. He regarded

² The abbreviation PIH will be used in the rest of the report when referring to the permanent income hypothesis.

permanent income as “the income flow resulting from an individual household’s ownership of marketable assets, the skills and talents at its disposal, the nature of its occupation, its geographical location, and so on.” He concluded that the difference between these two concepts is due to transitory income. Modigliani (1986) explains: “...we can reach one conclusion fundamental for an understanding of individual savings behaviour, namely that the size of saving over a short period of time, like a year will be swayed by the extent to which current income departs from average life resources.” Friedman’s PIH was the first major breakthrough in the research on the saving behaviour of households. Mikesell and Zinser (2001: 9) claim that “Friedman’s PIH is the starting point for a variety of specifications of the saving-income relationship.”

In its most simple form the linear equation is:

$$S_t = \alpha_0 + \alpha_1 Y_{Pt} + \alpha_2 Y_{Tt} \text{ ----- (2)}$$

Where:

- S_t = gross domestic saving in year t
- α_1 = constant marginal propensity to save
- Y_{Pt} = permanent income and
- Y_{Tt} = transitory income in year t.

Equation (2) is the simplest specification of the permanent income hypothesis. Friedman explained that at α_1 , the individual consume nearly no transitory income where marginal propensity to save on this transitory income will be unity ($MPS_t = 1$). The size of marginal propensities to save out of the permanent and the transitory income as well as the effect of initial wealth on savings is relevant for empirical testing of the PIH. Nevertheless, changes in transitory income will automatically result in changes in the level of savings. The argument is that transitory income cannot generally be anticipated because it’s a result of occurrences such as an inheritance (Rousseas, 1972: 173).

Furthermore, Friedman (1957) raised the issue of income inequality and saving. He argued that a reduction in the inequality of the permanent income status is neutral with respect to the savings ratio (*ceteris paribus*). It is the inequality in the transitory income components, which means uncertainty about income prospects, which, in turn, increases the need to save for emergencies as postulated by Mikesell and Zinser (2001: 9).

2.3.2.2 Critical Evaluation

The PIH provided the first major breakthrough in the literature on household savings behaviour and received empirical support. According to Kelley and Williamson (1968), the marginal and average propensity to save tends to rise with a positive interaction between wealth and income. Gupta (1970) found that marginal propensity to save is an increasing function of income at lower levels of development.

Based on Friedman's version Campbell (1987) redefines disposable income as the total of earnings and asset income, and shows that saving is the difference between disposable income and consumption. For Carroll and Summers (1991: 300) "if income growth is anticipated, saving should be negative, so that the PIH is consistent with high household savings (e.g. Thailand, Indonesia, Japan, Korea, Hong Kong and Taiwan) only if the residents of those countries continue to be surprised by the growth of their incomes. Viard (1993: 555) claimed that the productivity slowdown of the early 1970s, which caused decreases in the rate of growth of future incomes, should also have generated higher saving if people were planning on smoothing their consumption over the rest of their lives.

According to Modigliani (1986: 299), a major limitation was that the systematic variation in income and needs (i.e. maturing and retirement and or changes in family size), which occurred over the life-cycle of a household, was not specified. Another important drawback of the PIH relates to children and the bequest motives, which were omitted. However, some results of empirical studies on this theory indicated divergence for both developing and industrial countries. For example, regarding household savings in developing countries, Bhalla (1980) for India, Musgrove (1980) for Latin America and Betancart (1971) for Chile, found that savings would increase with permanent income as conventionally defined, which means that the elasticity of consumption with respect to measured consumption is less than unity.

2.3.3 Life-Cycle Hypothesis

The life-cycle theory of savings behaviour was first formalized by Franco Modigliani and Richard Brumberg (1954) and Albert Ando and Modigliani in 1963. It resulted in an important post-Keynesian debate that contributed much to the theorising about saving.

2.3.3.1 Original Formulation

In its original formulation, the life-cycle hypothesis (LCH) presented a theory of saving behaviour focussing on the individual. The LCH analysed the saving behaviour of individuals who spread their lifetime consumption over their lives by accumulating savings during earning years and maintaining consumption levels during retirement. This theory assumes:

- (i) that there are opportunities, in which income is constant until retirement and zero with zero interest, rates thereafter, with zero interest rates.
- (ii) tastes or preferences to be constant over life, with no bequests (no children).

The simplified assumptions of this model are illustrated in Figure 2.1 below. It is referred to as the basic or ‘Stripped – down’ version of the life-cycle model (Modigliani (1986: 300)). The main motive or reason to save here is for retirement and to acquire wealth.

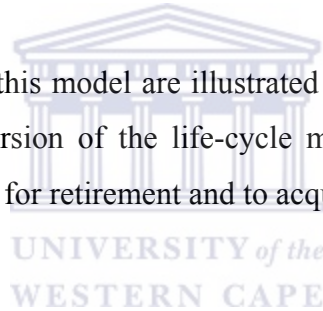
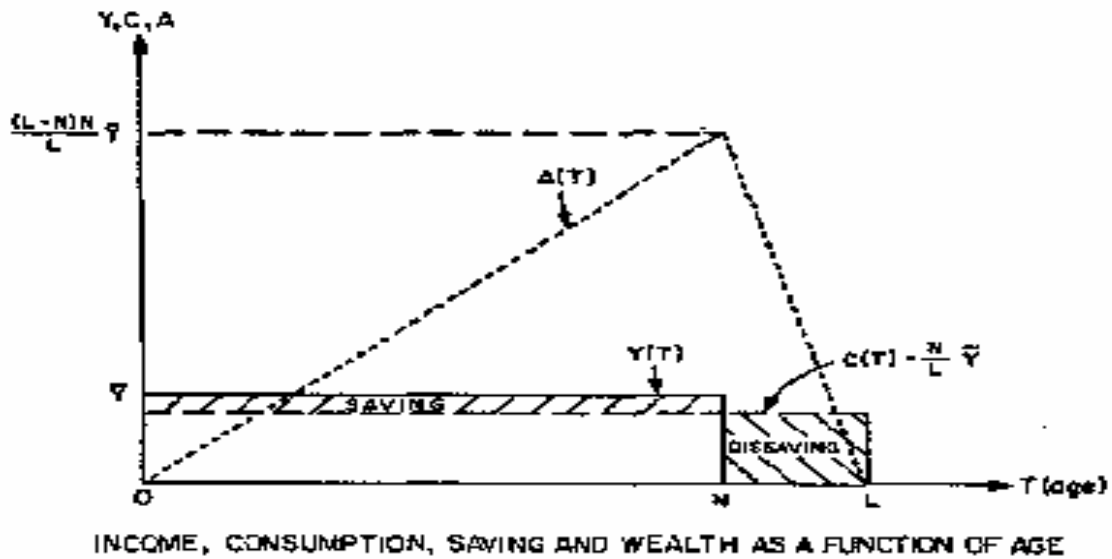


Figure 2.1 Basic Model of the Life-Cycle Path of Saving and Wealth



Source: Modigliani (1986:300)

Figure 2.1 presents a graphical illustration of the original LCH. It represents the age distribution of income, consumption, savings and wealth (Y, C, A), up to a constant number of people in each age interval (T). $[(L - N) N/L] \hat{Y}$ is the ratio of income-age at equilibrium levels of age N . $C(T) - [N/L] \hat{y}$ is the consumption ratio at equilibrium where dissaving occurs. N and L indicate the age intervals. $\Delta(T)$ is the upward sloping curve of the life-cycle of saving. $Y(T)$ represents the age at which people save. The retirement phase follows the earnings span and consumption smoothing causes to a humped-shaped age path of wealth holding. Roy Harrod (1948) called it 'hump-saving'. Aggregate wealth /income ratio (W/R) is given by the ratio of the total wealth held at each age (in the graph it is the area under the wealth path to the area under the income path). This can only be true in a stationary economy. But when the above analysis is applied to an open economy, the picture is different. According to Modigliani the retirement span follows the earnings span, consumption smoothing leads to a humped-shaped age path of wealth.

2.3.3.2 Later Refinements of the Model:

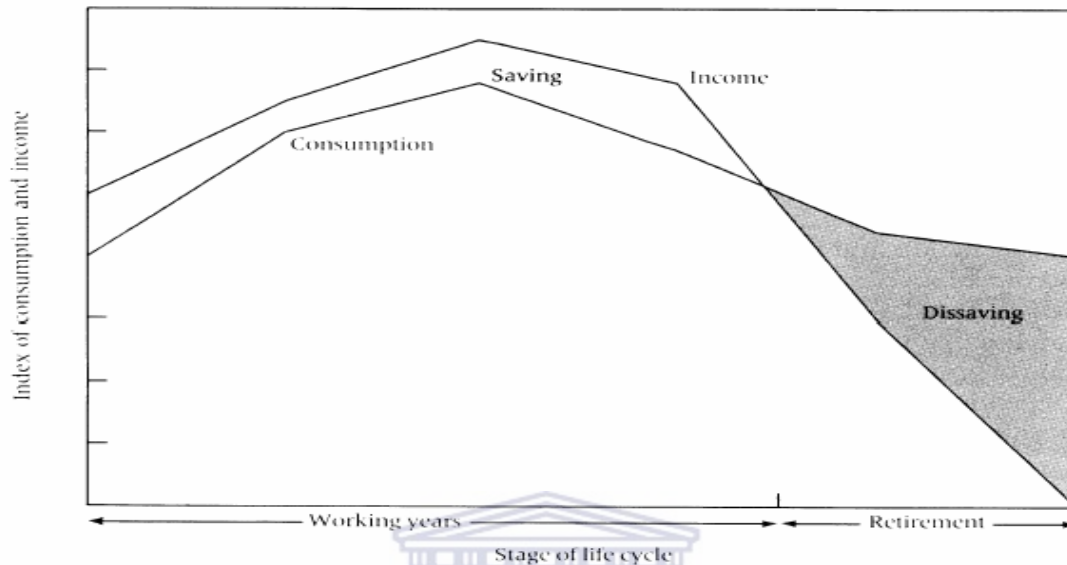
Modigliani expanded the perspective of the hypothesis in a number of later articles. As said previously, this model has the basic assumption that most individuals are not prejudiced but rather take their expected lifetimes into account when deciding how much out of current income to save and how much to spend (Modigliani, 1986:303). According to him, most evidence on age-saving and/or age-wealth profiles is based on a concept of disposable income that does not take into account the role of compulsory savings through pension schemes. Modigliani always explained that the LCH is a *theory about individual and aggregate wealth*, and that individual wealth and saving behave completely differently than the corresponding aggregate.³

The life-cycle predicts that, in any given population, young people will save too little (because individuals initially, earn relatively little and borrow to fulfil their high consumption needs). Middle-aged people with high earnings tend to save the most (because a typical individual's income increases and he/she no longer needs to borrow and therefore saves more). The elderly tend to have a low, or even negative savings rate (because once the individual reaches the retirement age, income drops to a level below consumption and dissaving occurs). In other cases, the individual must dissave in order to maintain his consumption close to his needs, until death (Modigliani, 1986). Thus, the aggregate savings ratio will tend to vary for the young, the middle-aged and the elderly. Ceteris paribus, the higher the savings ratio by the middle-aged households, the higher will the aggregate saving ratio be in any given country.

Years later, Masson (1988: 97) and Deaton (1999: 51) illustrated the life-cycle model in simple terms as shown in Figure 2.2.

³ This is consistent with what was later referred to as 'The paradox of thrift'. See Mohr and Fourie (2004).

Figure 2.2 Consumption and Income Age Profiles and Corresponding Savings over the household life-cycle



Source: Masson (1988:12).

In this graph, it is assumed that consumption and earnings vary over the household's life-cycle so that income is not equal to the desired expenditure at any point in time in a perfect market. Figure 2.2 also illustrates the saving behaviour of an individual during his lifetime. Savings increases as income increases, reach maturity and start to decline after a long period of working years. But, according to the life-cycle saving theory, there are means by which households can shift income from time to time so that their consumption could be fulfilled (Deaton, 1989). That is why during times of high earnings relative to desired consumption, households save and during periods of low earnings relative to high consumption, households dissave. Therefore, incomes rise over the life-cycle until retirement. Retirement is therefore the main saving motive.

One of the implications arising from of the LCH is that the higher the old age dependency ratio, the lower will be aggregate household savings, as these people dissave during retirement. Thus, aggregate savings at any point in time will depend on the savings ratio of working households as compared to the savings ratio of retired households.

2.3.4 Critical Evaluation and Empirical Findings

- Lussardi (1999) emphasises that the LC model provides the main framework to study the accumulation of saving and wealth. The contribution lies precisely in the adaptation of this theory to the aggregate savings of households both in a stationary as well as dynamic context. Also, Deaton (1992) and Modigliani (1993) commented, "...The model predicts a relationship between savings ratios and income growth that is close to that shown in respect of the cross-country evidence." Another study by the World Bank (1993: 204) also found a high correlation between income growth and saving.
- Despite empirical support, many economists noted limitations. For example, Wolff (1981) divided families into three classes: the capitalists, the primary working class and the secondary workforce. He found that of life cycle wealth only relates to the primary working class takes. Katona (1960, 1980) stressed that psychological aspects of individual economic behaviour were also relevant to the savings motive. He also argued that income is positively related to the savings motive. Shefrin and Thaler (1988) analysed a behavioural life cycle and claimed that their model is a more general model whereas the life-cycle model represents only a special case.
- According to Mikesell and Zinser (1973) and Weil (1994), more evidence on the famous life-cycle of savings showed that some individuals continued to save even at old age. While Carroll (1997) argues that "the typical household's savings is better described by a "buffer stock" version than by the traditional version of the PIH/LCH model. Caschell (2005) claims that to "the extent that social security involves a transfer of income from workers to retirees, it tends to reduce household savings by shifting resources from potentially high savers to those who save less."
- Another criticism is that it fails to predict accurately. For example, no use is made for representative agents. For example, in practise the age profiles of consumption and income usually have shapes that are much more realistic. Consequently, there are not enough humps savings in the data to account for aggregate wealth in the economy, with the implication that a substantial amount of national wealth should be attributed to bequests (see Kotlikoff, 1988; Kotlikoff and Summers, 1981; and Modigliani, 1988).

However, Jappeli (2005) claims: "The beauty of the LCH is that aggregation is not nuisance, but part of the model itself, delivering some of the most interesting results." However, as Browning and Crossley (2001) and Attanasio (1999) explain: the life cycle model provides a general framework that cannot include every aspect that affects the saving behaviour of low-income households.⁴

⁴ See Appendix 2(a) for a more schematic version of the life-cycle model and Appendix 2(b) for a comparison of the hypotheses

2.4 OTHER DETERMINANTS OF HOUSEHOLD SAVING BEHAVIOUR

Despite the applicability of the traditional above theories on household savings behaviour, they focused on typical households in developed countries, whilst in developing countries; the majority of households are poor. Masson *et al* (1998) also states that the determinants of household saving in rich countries are different from those in developing countries

Deaton (1990) and Gersovitz (1988) identify several reasons why the savings behaviour of households in developing countries may diverge from the textbook case:

“households are dynastic that survive beyond individual members; (ii) households are indecomposable units and savings are decided at the household rather than individual level; (iii) households have lower and more uncertain income; (iv) borrowing constraints may be much more pervasive; and (v) savings provide a buffer for an uncertain and unpredictable income rather than intertemporal consumption smoothing.”

A survey by Browning and Lusardi in 1996 emphasised the fact that it is not easy to establish the motives of saving for any society. This section reviews some of the most important additional factors that were found to be relevant in understanding household savings in developing countries.

2.4.1 Income Level and Income Uncertainty

Empirical research recently underlines the fact that saving ratios are low where income is low or near to subsistence levels. In developing countries however, saving ratios differ partly because of the per capita income level. The magnitude of this effect is likely to decline as per capita income increases (Carroll and Weil, 1994). Therefore, the very low per capita incomes render it almost impossible for households in developing economies to save. Kraay (2000) finds that savings ratios and levels of income per capita exhibit a modest positive correlation. He claims that average saving ratios rise as household income increases beyond the base minimum required for survival. For Chakravarthy and Patnaik (1970) consumption, savings and investment patterns may be related to income in at least two ways; firstly through the level of income and secondly through the trends of income change.

Deaton (1989) explains that household income in developing countries is uncertain and cyclical, making longer-term estimation difficult. He also suggests that saving behaviour of individuals may be directed by rules of thumb, and emphasized that short-term increases and/or decreases in income are the primary causes of saving/dissaving (Deaton, 1992). For Caballero (1990) the uncertainty of expected income would enhance the precautionary motive for saving in a stable macroeconomic environment. But in developing economies where such environments are often unstable, increased uncertainty may reduce saving through its effect on the variability of rates of return.

2.4.2 Intergenerational Links

Intergenerational links were found to be a significant determinant of savings behaviour in developing countries, where these links are particularly strong due to the large sizes of families. Gersovitz (1988) found that extended family links might lengthen the effective planning horizon over which households make saving decisions. Deaton (1989) agreed that households in developing countries are larger than in industrialised countries and more likely to consist of several generations. As a result there is less to save for retirement or for intergenerational transfers. Furthermore, Oberta (2006), in analysing the role of children and family size on household saving, stresses the negative and regressive effects that additional children have on both the saving ratios and levels of households saving.

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2.4.3 Liquidity Constraints

The measured incidence of liquidity constraints was found to be substantially greater in developing countries (Rossi; 1988). Households in these countries often have a limited access to credit markets and credit is mostly rationed. A panel study by Schmidt - Hebel et al. (1992) found that liquidity constraints play an important role in the case of developing countries. Veidyanathan (1993) used annual data for three decades of a group of sixty countries and came to the conclusion that households in developing countries are subjected to serious liquidity as well as saving constraints. Deaton (1989) mentioned that especially young people in developing countries are likely to experience credit constraints. Such constraints should ease with the development of the financial sectors, as intermediation develops that will facilitate more efficient saving and borrowing.

2.4.4 Consumer Behaviour

Saving and consumption are mirror images, which means that anything that increases consumption will reduce saving. If for example households increase their consumption expenditure (buy more luxury commodities), this will affect their ability to save. Household decisions on how much to consume and how much to save are analysed by models focusing on intertemporal optimization. In the absence of borrowing constraints, the first order condition of such models is: the ratio between marginal utilities in any two periods has to be equal to the expected discount rate. Individuals borrow and save as outlined above in order to smooth consumption over time.

Any change in the discount rate will change the opportunity cost of current household consumption. In the absence of market imperfections the level of consumption (and therefore saving) today will change in the future. However, market failures are rife in developing economies, and as a result the elasticity of substitution is unlikely to be unity. Poorer households who are closer to the poverty line, may have less flexibility to substitute consumption between periods, thus their savings ratio is likely to be rather inelastic relative to that of richer households (IMF; 1995).

2.4.5 Interest rates and Inflation

In the case of interest rates, it was generally found that countries with a high savings ratio, interest rates were not uniformly positive (World Bank, 1993: 205). In some countries real interest rates tend to be more stable and less negative in other countries. Also, Dornbusch and Reynoso (1989: 205) note, “virtually no study has demonstrated a discernable net effect [of real deposit rates on saving ratios].”

From a theoretical point of view, it seems that the impact of the interest rate on savings is uncertain. This can be explained by means of the income and substitution effects that generally function in opposite directions. Overall then, it appears that a change in real interest rates has an uncertain effect on saving, largely because of the competing income and substitution effects resulting from the change in interest rates. The income effect leads to higher current consumption. For example, when income increases, savers receive higher interest payments and can afford to spend more (Miles and Scott, 2004: 311). An example of the substitution effect is when the interest rate increases (here it is an

intertemporal price) the first period consumption becomes more expensive so that the individual substitutes away toward second period consumption, through saving more (Miles and Scott, 2004: 311).

The final effect of interest rates on saving seems to be inconclusive. In developing countries, the response of savings on interest rates seems to be weak. Ogaki, Ostry and Reinhart (1996) argue that households only save at levels of income substantially above the subsistence level. Generally, an increase in the interest rates increases savings but the real income effect of higher interest rates can affect savings adversely. Koskela and Viren (1982) confirmed that savings increase as real rates of interest increase.

In the case of developed countries, Ouliaris (1981) examined household savings behaviour in Australia and determined that positive real interest rates exert a negative influence on the saving ratio and a fall in real interest rates contributed to the rise in the savings ratio. Giovannini (1985) provided evidence that for the majority of cases, the response of saving growth to real rates of interest is not different for developing countries. Furthermore, he claimed that "...in developing countries, assumptions about elasticity of substitution may not be realistic because a significant fraction of the population may not be able to borrow, even at black market rates."

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Household saving also responds to the rate of inflation. Higher inflation tends to lead to higher nominal interest rates and hence higher measured household income and savings. According to Agénor (1999: 23), inflation variability affects saving in opposite directions:

- to the extent that it increases uncertainty about future income, a high degree of price variability may lead to an increase in the saving rate, as a result of a precautionary motive to save
- but to the extent that a highly rate of inflation goes together with more uncertainty on the real rate of interest (or the return on saving), it may have a depressing effect on the decision to save.

2.4.6 Market and Government Failures

Relevant for the study of saving, is market failure in several instances, such as the lack of information as a result of financial illiteracy, and incomplete markets as a result of adverse selection (Black et al., 2005: 21). These instances of market failure often distort the decision of individuals to save. Lavoie (1994: 543) explains that in real life households lack perfect knowledge and the ability to process a large amount of information. They also lack confidence in their interpretation of the available information that can distort their consumption and saving decisions. As a result of market failure governments should play a strong role in implementing strategies to create a culture of saving.

However, government failure is also very real in developing countries. Governments in these countries often fail to implement suitable policies to correct for market failures. There are also the issues of corruption and rent-seeking by bureaucrats, politicians and other interest groups.

2.4.7 Social Security, Pensions, and Insurance

In recent years, the number of social security schemes, pensions funds and insurance schemes increased significantly in developing countries. These compulsory savings schemes are thought to benefit approved financial institutions but also lower the private savings rate. Agénor (1999: 25) identified three channels in which these effects occur:

- by redistribution of income to the elderly;
- by reducing the need to save for retirement;
- by curbing the need for precautionary savings to cover the contingency of living longer than expected.

The affordability of various kinds of insurance such as insurance related to health, or liability or unemployment or personal loss, etc, may influence the saving behaviour of households. Insurance payments also limit expected cash flows for emergencies and contingencies. Various insurance schemes reduce income uncertainty and thus the need for precautionary savings, logically depending on the extent of insurance cover (Agénor, 1999: 26).

However, in some emerging economies, the economic effect of compulsory savings schemes on household saving was positive (World Bank; 1993).

2.4.8 Cultural factors

The issue of culture attracted many questions and discussions in the economic debate. However, in poor developing countries (such as in Sub-Saharan Africa) cultural aspects are important in the decision to save. Granato et al. (1996: 108) define culture as a "...system of basic common values that help shape the behaviour of the people in a given society." These authors further commented that this value system often takes the form of religion. Thomson (2001) defines culture as: "The total complex pattern of customary human behaviour, social forms and material traits embodied in thought, speech, action, and artefacts, and dependant on the human capacity for learning and transmitting knowledge and systems of abstract thought. This will include beliefs, morals, laws, customs, opinions, religion, superstitions, and art." For Ingham (2000), culture is "... best appreciated as a learned behaviour passed from one generation to another not as some exogenously determined endowment which facilitates or constrains development."

Moreover, culture influences the environment through different channels, the main one being trust⁵ (Frederking; 2001: 106). Fukuyama (2001: 313) identifies four ways through which culture influences economic behaviour. These are:

- the impact on production and organizations;
- attitudes of consumers and workers;
- the creation of institutions;
- the creation of social networks and social capital.

The last one links culture and savings matters in developing countries in the informal sector. This link is often strong because of the cultural background of poor households in Africa. Savings and cultural aspects have a strong correlation in the literature of informal savings mechanisms (See Robinson, 2001).

⁵ Trust lead to an increase in the cooperation ability between individuals and decrease transaction costs and the inclination for rent seeking (Frederking (2001).

2.5 SAVINGS MOBILISATION IN DEVELOPING COUNTRIES

Poverty means that the income of the people concerned are so low that it is difficult for them to even satisfy the most basic consumption needs. Saving under such circumstances is almost impossible. About 90% of people in developing countries cannot access the services of financial institutions (Robinson, 2001: 6).

Also, in developing countries (particularly in Sub Saharan Africa), household savings are primarily in the form of non-financial assets (Aryeetey and Udry; 1999). Mwega (1997) indicated that the low savings ratio in Sub-Saharan Africa reflects both the private savings function and the initial economic conditions.

2.5.1 Poor Households Do Save

However, research proved that “the poor household wants to save and do savebut it not easy”. They save in kind or in cash to provide for difficult periods. Studies done by Dauner (2004: 3) found that this segment of the population saves because they have particular reasons or motives to do so. When asked why they save, poor households responded as follows:

- To decrease their vulnerability to shocks (income, health, death, etc.);
- To accumulate lump sums for;
- Life-cycle needs (birth, wedding, death).
- Investment in human, physical and social capital.
- To bequeath relatives and friends
- To obtain a credit.

2.5.2 Savings Mobilization of Poor Households in Developing Countries

In the studies of saving, formal financial institutions frequently ask the question of how poor households save since they are the potential deposit receivers (Dauner, 2004: 4). Poor households save in various forms, for reasons and purposes specific to their needs and entrust their monetary savings to different persons or places (neighbours, financial institutions, under the mattress, etc.). Wright (2001:2) mentions that many emergencies or opportunities necessitate instant access to cash, and this explains why almost all low-income and poor families keep some amount of emergency savings in the home. Also, an empirical study by Goldstein and Barro (1999) in West Africa showed how a poor woman use different savings services for different purposes for example:

- in decentralized financial systems in order to obtain credit;
- at the deposit collector in order to manage liquidity of her economic activity;
- in tontines, for future consumption, health expenses, housing etc.

Furthermore, Rutherford et al. (1996) identified several situations (when, where and how) under which low-income households save. It was find that they save when:

- They feel their savings are secure.
- The amount of their savings is kept secret to others.
- They can access all or part of their savings when needed.
- They have the possibility to save often and easily.
- They are entitled to obtain a credit (reciprocity).
- They feel they own their saving (their savings are not owned by a group).
- They feel the savings are growing and protected from inflation.
- They feel under some social pressure to save.
- They know at any time how much they have.

The following paragraph explains the role of institutions to mobilise the savings of the poor.

2.5.2.1 Informal Saving Mechanisms

The informal financial sector is the primary source of financial service provision available to low-income or poor households in Africa. According to ECIAfrica Consulting (2003:8), informal financial associations (such as ROSCA's, NGO's and other non-bank institutions) are those suppliers who do not fall under the jurisdiction of laws, taxes and other regulations.

According to Robinson (2001: 6), poor households use similar forms of informal savings in developing countries irrespective of their saving purposes. For example, in many developing countries in Asia, Africa, and Latin America, all types of savings are found in some form or other in all countries. Nevertheless, the forms in which the poor save are usually: cash; grain and cash crops, animals, gold and silver, jewellery and other valuables, land, rotating savings and credit associations (ROSCAs), also known as accumulating savings and credits associations or ASCAs, raw materials and finished goods, construction materials, cash or grain lend out for profit, deposit with informal savings collectors, and labour organisations (Robinson; 2001). However, informal savings mechanisms or non-banking systems, referred to as the ROSCA's, are the most commonly used in many developing economies. In the following discussion, the focus will be on the ROSCAs.

The international literature commented that ROSCAs and RESCAs/ASCAs are extremely popular throughout developing countries because of social benefits arising from membership. Besley et al. (1994: 701) stated that: "ROSCA's are widely observed institutions for financial intermediation. They are found all over the world, particularly in developing countries...". Calomiris and Rajaraman (1998: 207) regard ROSCA's as "...financial institutions widely reported in the developing world." For Levenson and Besley (1996:45), "informal finance is an important source of access to credit and savings opportunities in low-income countries." Timber and Aiyar (1994: 43) argued that informal financial markets account for much of the business credit in developing countries. Lastly, Van den Brink and Chavas (1997:745) started their analysis of ROSCAs's with the following scenario, "... Imagine an individual somewhere in Africa faced with the problem of financing a major purchase."

The point is informal financial organisations originated in developing countries and is becoming less important or competitive as formal markets develop. ROSCA's are perceived to be characteristic of developing and low-income countries and developed where formal financial institutions were not well developed, e.g. in Taiwan, where the financial sector was underdeveloped but the personal savings ratio was high (20% for a long period) (See Besley and Levenson, 1996). Also, according to Van Ginneken (1999) informal financial organisations develop where financial and insurance markets are still underdeveloped e.g. in Sub-Saharan Africa. Jutting (1999) found that "it is

generally accepted that ROSCA's play a very important role for people otherwise excluded from formal financial institutions.”

2.5.2.2 The Role of Government

The role of government to building an inclusive financial system for all is a controversial topic.

Financial Sector Reform:

Firstly, the financial sector needs to be reformed. The goal of countries embarking on financial reforms is to improve the efficiency of financial sector while maintaining financial stability. It is believed that a stable and efficient financial sector provides the opportunity for implementing effective stabilization policies, boosting savings and improving the efficiency of investments (Agarwal, 2004). According to Modigliani and Cao (2004), reforms of the financial sector provide a sense of security in rural areas, which can contribute towards an increase in rural household savings in the form of investments in land and housing.

Promoting Microfinance:

Governments should ensure a favourable policy environment within which microfinance flourish. Rosenberg (1994) and Christen et al. (1995: 9) argued, “in most countries (with the exception of Bangladesh and Indonesia), microfinance programs have not yet succeeded in reaching the majority of poor households. This issue became more interesting when in 2004 it was included in the discussion of the G8 industrial countries⁶. According to the World Bank (2000), the growing interest in microfinance derives from the increase in demand by the poor people and the shortage of supply to meet their needs. Microfinance for the poor was suggested as a poverty-reducing strategy and a set of principles formulated by CGAP⁷ was accepted (Helms, 2006: 75). Some governments such as Tanzania and Philippines have already introduced national microfinance strategies.

Helms (2006: 76) claims that the role of government in this matter should be:

- delivery financial services directly and indirectly;

⁶ Meeting of the G8 industrial countries at their Sea-Island in Georgia, USA (2004).

⁷ CGAP stand for Consultative Group to Assist the Poor).

- introduction of policies that will affect the financial system;
- proactively to promote inclusion by offering fiscal incentives or requiring financial institutions to serve the poor.

The last option seems to be more appropriate for governments in developing countries. Yaron (1992b) claims that the microfinance revolution depends on institutional sustainability. The World Bank developed a range of indicators that measure the quality and the importance and governance of institutions across countries. These measures reflect six themes, which include the voice and accountability, political stability and lack of violence, government effectiveness, regulation quality, rule of law and lastly lack of corruption (Miles and Scott: 2004: 95).

2.5.2.3 Microfinance (Private sector)

The majority of low-income or poor households are marginalized and regarded as unbanked. They are not normally served by the commercial retail banking sector. Involving impoverished communities in their own economic empowerment led to the creation of the concept of microfinance. In general, microfinance refers to programs that provide small scale financing facilities such as savings and credit to individuals that would in all likelihood not have access to alternative forms formal financial services.⁸ The savings services (also referred as microsavings) give households confidence to save excess cash for future consumption. The credit services in contrast facilitate the spending of an anticipated income for current consumption or investment (Robinson, 2001: 9).

Microfinance services offer two main advantages.

- (i) It is an initiative in which personal upliftment is promoted.
- (ii) It helps poor households to reduce risk, improve their financial skills. increase their productivity, gain higher returns on their investments,
- (iii) Increase their incomes, and improve their living standard of the household.

⁸ For Robinson (2001: 9) “Microfinance refers to small-scale financial services (primarily credit and savings) provided to people who farm or fish or herd; who operate small enterprises or micro enterprises where goods are produced, recycled, repaired, or sold; who provide services; who work for wages or commissions; who gain income from renting out small amounts of land, vehicles, draft animals, machinery and tools; and to other individuals and groups at the local levels of developing countries, both rural and urban.”

Microfinance and its various manifestations around the world will not be discussed in depth, but attention will be given only to micro saving.

Mobilising savings is never easy for the poor. The problem is aggravated because they do not have any bargaining power to obtain microfinance. They usually cannot discuss their creditworthiness and saving issues with the formal financial institutions. Robinson (2001: 10) put it in a single phrase: “those who hold the power do not understand the demand and those who understand the demand do not hold the power.

2.6 SUMMARY AND CONCLUSION

This chapter discussed the theories on household saving behaviour. Other recent views that emerged in the study of household saving are also addressed. The major findings of all these theories are that savings is that part of income that is not spent or consumed. Income was found to be the main determinant of savings for a variety of purposes such as precautionary and bequest motives.

The fundamental reasons or importance and role of households to save were highlighted. Empirical investigations carried out to date also appear to support these general propositions accepted for developing economies.

Evidence for developing countries (particularly for the Sub-Saharan Africa) proves that household savings behaviour postulated by the traditional theory is undesired for poor households living in those countries. Therefore, it will be safe to proceed, in the present investigation, from the premise that low savings ratios by households in developing countries impact negatively on the investment potential and hence on the economy as a whole. Also empirical evidence showing how households save through informal saving mechanisms made it possible to include additional factors that can explain the reality of household savings in developing countries. Although these households lack a ‘culture of saving’, it will be important to review how the high savings countries implemented such culture.

The following chapter provides a brief overview of the East Asian countries where household were very poor at the beginning of the 21st century and successfully established the culture of saving through generation.

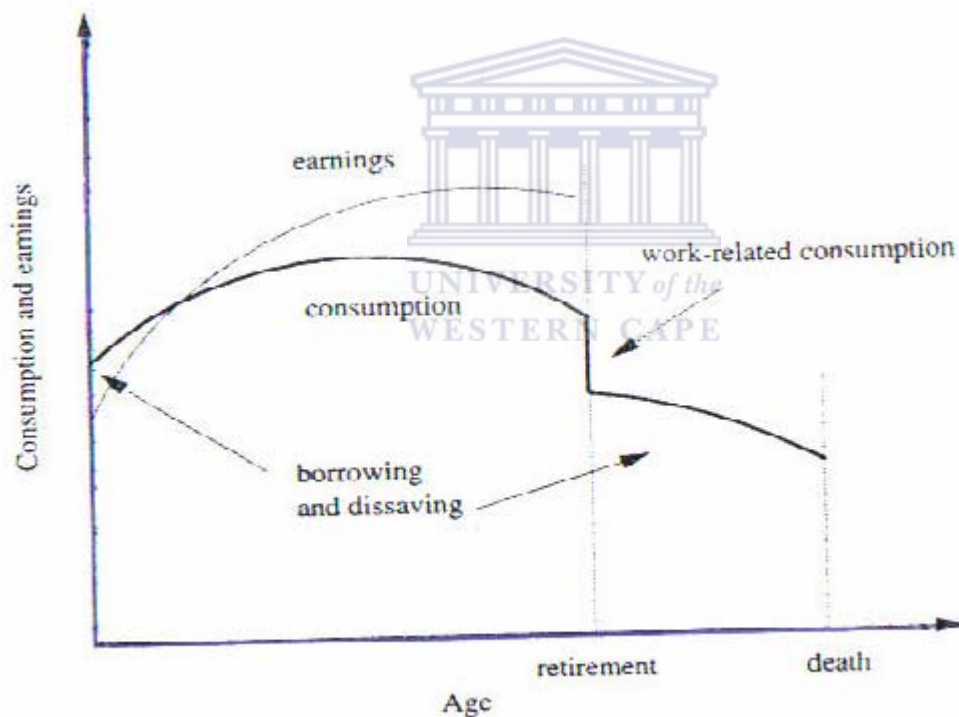


APPENDIX 2(a)

LIFE-CYCLE MODEL

A more schematic version than the basic or simple stripped-down model is illustrated in figure 2.3. In this figure, while the hump in consumption reflects the changing demographic composition of the households as children are born, grow up and leave; the hump in earnings reflects the standard-age profile. It is assumed that consumption drops at retirement, not because of the decrease in income, but because of other reasons such as expenses associated with work (e.g. transportation, working clothes, meals, etc...). These types of expenses are apparent in the developed countries such as UK, and the U.S.A (Deaton, 1999).

Figure 2.3 Schematic Life-Cycle Profiles of Earnings and Consumption.



Sources: Deaton (1999: 42)

Figure 2.3 illustrates a typical life-cycle of savings where individuals want to borrow at the beginning of their career, save at the middle ages when they are at the peak of their earnings, and decrease their savings (dissave) after retirement. If one can measure the average age of each rand

saved and each rand borrowed or dissaved, then as illustrated, the average age of the rand saved is less than the average aged of the rand dissaved (Deaton, 1999:42). This can only happen with assumption of *ceteris paribus*.

APPENDIX 2 (b)

THE DIFFERENCE BETWEEN THE TWO THEORIES

LCH and the PIH were developed and published in the late fifties. The main difference between these two theories lies in the length of the planning period or time horizon.

Time horizon: The permanent income hypothesis has an infinite time horizon, while the life-cycle hypothesis is a finite horizon model (Attanasio, 1999). For Friedman, this period is infinite, meaning that people save not only for themselves but also for their descendants or bequests. In the Modigliani-Brumberg version of the theory, the planning period is finite.

Comparing the two theories: Both theories use a concept of long-term income. The definition of long-term income differs from one theory to another, but it is related to the household's expected income over a long period of time. According to the LCH, the long-term income is the income that the household expects to earn over its life-time (also called life-cycle income). The assumption of a LCH is that every household has a view of its life-time income. The expected income is converted into a single figure for annual permanent. In the LC theory this permanent income is the maximum amount that households could spend on consumption and save each year indefinitely without accumulating debt that are passed on to future generations (Lipsey, 1990: 552).

In some cases, PIH and LCH share similar predictions about individual saving behaviour, for instance, in respect of transitory income shocks. But many implications of the LCH about individual and aggregate savings ratios are unique, and differ sharply from the infinite horizon version of the model. The distinction between the LCH and the PIH models is more evident when one looks at the aggregate implications. Indeed, the PIH clarified the very few "aggregate" predictions.

CHAPTER THREE

HOUSEHOLD SAVING: INTERNATIONAL EXPERIENCE

3.1 INTRODUCTION

The High Performing Asian Economies (HPAE's), led by Japan, have remarkably high ratios of aggregate saving and also of household saving. The East Asian phenomenal economic growth is often attributed to its high saving ratios (World Bank 1993: 203). For instance, the average household saving rate in the region was 30% of GDP in the 1990s (World Bank: 2002). Many countries in this region successfully created a 'culture of saving' within the household sector.

At the beginning of the 20th century, households in these East Asian countries were just as poor as many of those in Sub-Saharan Africa today, but they managed to turn the situation around. Even after the financial crisis in the emerging market economies, households in these countries managed to sustain their level of saving (World Bank, 2002). Given the deteriorating situation with regards to household saving in South Africa, it is important to investigate the situation in these countries in order to try and find answers from which lessons can be derived. Which factors are behind these success stories: specific government policies, efficient financial institutions or special features of households? This is the focus of this chapter.

Section 3.2 discusses the relevance of the determinants of household saving as identified by economic theory and empirical evidence in the case of some Asian Tigers. Thereafter Section 3.3 presents case studies with specific information on three of the countries, Singapore, Malaysia and China. Section 3.4 concludes.

3.2 SAVING PERFORMANCE OF THE ASIAN ECONOMIES

Countries with high saving ratios of household saving had a combination of specific factors responsible for their saving performance and it is important to understand and to evaluate their relative significance (Bhanoji Rao, 2002).

3.2.1 Income growth

According to the traditional theory income is the main determinant of saving as explained in Section 2.3. Empirical evidence on saving in the Asian countries indicates that there is a strong relationship between economic growth and the saving ratio. For example, Lahiri (1989) estimated saving equations for each of the eight countries in his sample and confirmed this relationship. Collins (1991) used time series data for 10 countries, but averaged the data over five-year periods to compensate for fluctuations in inventories of rural households. He also found a significantly positive coefficient for economic growth in their estimations of equations of saving rates. Growth of national income means higher earnings for households, or jobs for previously unemployed, which are necessary to be able to save more.

For some countries in the region (Indonesia, Japan, Korea, and Thailand) income growth was a good predictor of increase saving rates. For other countries (Taiwan, China, Malaysia and Singapore) other factors than income growth were relatively more important (World Bank, 1993).

Recent studies suggest that the causality between saving and growth may not run in the direction that is commonly believed. The World Bank (1999) in its report *The East Asian Miracle* concluded: "...growth drives saving rather than the other way around". In a separate examination of four Asian countries, other researchers made a fairly unambiguous finding: "In all four countries (Japan, South Korea, Singapore and Hong Kong) economic growth was high early and saving was high later". This suggests a significant lag. In South Korea, for example, economic growth averaged 6.1 percent for the period 1960 to 1974, whilst the average growth in saving was only 10.4 percent. In the subsequent period, 1977 to 1987, saving grew with an average of 27.8 percent and economic growth with only 5.3 percent.

3.2.2 Demographic changes

Horioka (1990) claims: “demographic factors may also interact with corporate behaviour to increase saving.” A demographic effect may exist when longer life expectancy can change life-cycle behaviour, thus leading to a longer working life and possible higher saving for retirement. In another related study, household saving were found to be strong and stable in the countries with many elderly people (Deaton and Paxon, 1992). Bloom, Canning and Graham (2003) confirm that longer life expectancy is strongly associated with higher national saving rates across countries.

Economists such as Fry and Mason (1982) argue that in countries undergoing rapid economic growth, the earnings of the young are higher than the earnings of retirees (who might be dissaving). If this is true, concentration of earnings among a high saving group should generate a higher aggregate level of household saving.

One of the predictions of the life-cycle hypothesis (See Section 2.3.3) is that a country’s aggregate saving will be high where middle-aged workers save more than those with a high proportion of young people (who are dependent) and elderly people (who dissave). A decrease in the dependency ratio will lead to an increase in household saving.

In general, household saving rates are higher when the dependency ratios⁹ are low and economic growth is rapid (Higgins, 1998; Kelley and Schmidt, 1996; Mason, Bayoumi and Samei 1998). They also regard the shifts in demographic structure of the populations of the East Asian countries (particularly in Indonesia, Malaysia, Singapore and Thailand) to be the main factor explaining the increase in their household saving ratio over a long period. The reason behind the fast change in the size and age composition of households was to discourage the rate of dependency burden (also called the dependency ratio).

Evidence that this contention is valid is confirmed by other studies on the impact of demographics on saving. While Bloom and Williamson (1997) find that population dynamics accounted for 1.4 to 1.9 percentage points of East Asia’s average annual per capita GDP growth during 1965–90. Higgins

⁹ The dependency ratio is the ratio of non-working age people to working age people (World Bank, 1993: 204).

and Williamson (1997) argue that had the age profiles in east and south-east Asia not changed between the early 1970s and early 1990s, household saving rates would actually have declined.

However, other authors such as Deaton and Paxson (2000) disagree with the findings as mentioned above. Using data for the Taiwan household saving, they find that changes in age composition accounted for only a modest increase of 4% in the gross saving rate. They claim that the increase in the aggregate saving rate was not mainly due to changes in the age composition of the population but rather to an increase in the saving rates of all age groups.

3.2.3 The Role of Institutions:

The East Asian governments played a major role in encouraging saving by both household and corporate sectors. The following are important elements:

Financial sector reform:

In the East Asian countries, the financial sector was underdeveloped at the beginning of the 19th century (World Bank, 1993). So it was necessary for the financial sector to be liberalized so that savings mobilization or saving products could become effective and efficient. Role of commercial banks. As stated in Section 2.5.2.2, government can promote saving and play a more active role through different vehicles (i.e. supervision and regulatory of the reform of the financial sector).

According to the World Bank (1993:205), some of the most important strategies by these governments were related to the reform of the banking sector. As the financial sectors were liberalised, governments in the HPAE's implemented incentives to ensure deposits. Governments in these countries performed the functions of supervision and regulation. For example, the governments frequently acted explicitly or implicitly to prevent bank failures through Central Bank intervention and consequently lowered the risk to depositors (World Bank; 1993: 211).

Compulsory saving:

In the case of the East Asian region, some governments enforced compulsory saving on employees and employers (World Bank, 1993). However, the effect of these compulsory saving schemes on household saving varies across countries and depends on the proportion of the liquidity-constrained

people to the total population. Furthermore the economic efficiency of these schemes is also questioned on the grounds that such saving simply replaced voluntary saving (World Bank, 1993).

Postal saving facilities:

Some governments created postal saving facilities aimed to mobilize saving particularly for the poor (low-income and rural households). By increasing the availability of saving instruments, financial deepening could potentially raise the rate of saving (Faruqee and Hussain, 1998). These postal-run saving schemes lowered transaction costs for disadvantaged savers and offered them relatively high levels of security (World Bank; 1993: 218). This fostered the mobilization of household saving (rural dwellers and people with low incomes in towns and cities) in Japan, Malaysia, Korea, Singapore, Taiwan and China. Mukai (1981) agrees that one of the major advantages of these schemes is that the transaction cost of deposits is less than that of the private banks.

Reduction in consumption:

Furthermore some public authorities introduced restrictions on the purchase of particular goods. According to the World Bank (1993), restrictions on luxury consumption goods, such as taxes on expensive consumer imports and restrictions on consumer credit financing may also have had some positive impact on saving. As a result of price rationing, consumer goods in the market were almost always in short supply.

The role of interest rates:

The relationship between interest rates and saving received positive support from scholars such as Fry (1978; 1980) who found that, across a sample of fourteen Asian developing countries, the gross national saving rate was positively affected by increases in real interest rates. Cheng (1980: 54) determined that for the Pacific Asian Countries, "...real deposit interest rates played a critical role in setting the rate of each nation's financial growth." He came to the conclusion that maintained positive real of rates on deposits over a number of years, would encourage financial deepening. Reynoso (1989) finds evidence that saving increases rapidly as real interest rates move from sharply negative to just below zero, but that the effect levels off at low positive real rates of interest and becomes negative when real rates are highly positive. Fry (1988); Lanyi and Saracoglu (1983) and

Gelb (1989) also documented a positive relation between real interest rates and the growth of saving deposits.

As Kuncoro (2001) put it: “Most East Asian economies are no longer at the lower end of the income spectrum so that increasing real interest rates from negative to modestly positive levels seems to be a positive factor in mobilizing domestic saving.”

Taiwan, Indonesia and Korea are examples of countries that successfully increased interest rates through financial liberalization, which positively impacted on private saving. However, in other countries such as Korea, Japan, India and Malaysia the degree of liberalization was not complete. These countries deregulated interest rates quite gradually according to Caprio *et al.* (1994) and Williamson and Mahar (1998).

Price level stability:

Lower levels of inflation resulted in increased household saving in the Asian countries because it encouraged households to save their wealth in the form of financial assets such as deposits saving (Kuncoro, 2001). According to Neal (1990), the HPAE's managed to control inflation which gave households confidence in saving. By contrast, high inflation that results in negative real interest rates on deposits can inspire people to save in the form of real assets such as durable goods. High inflation can also encourage households to invest in foreign currency, causing capital flight (Human Development Report, 1999).

3.2.4 Social- cultural Determinants: the Confucian Ethic

Economic factors are not the only motive behind household saving. Social and cultural factors should be taken into account when investigating the saving behaviour of households, particularly in the case of the Asian-Pacific region. It was said earlier that culture plays an important role in the saving behaviour of households and also in the economic development of nations.

The saving behaviour of households is governed by social and cultural factors. The concept of Confucian ethic is in fact always a motive for saving in the East Asian economies. Initially, Confucian values emphasize interdependence between family members and a respect for education

(Barringer, Gardner, and Levin, 1993). The Confucianism and economic development theme was developed by Hung-Chao Tai in 1989. He observed that in Asia people have a conscientious work ethic together with a modest life style and relatively high saving. Harry Oshima (1987:67) explains, “Hard work and saving for education are strongly emphasized in the Confucian cultures.” Also in a related analysis, Heroika (1990: 56) cites numerous researchers who argued, “the propensity of Japanese people to work hard and save is due in large part to the Confucian heritages.” However, Heroika recognized that this is difficult to prove empirically. According to Chandavarear (1993), it is impossible to measure the role of socio-cultural determinants of household saving. However, in some countries, their influence is easily identifiable.

3.3 CASES STUDIES

Case studies can be very useful in many instances. However, their results may not be used for generalization because it is difficult to test them for validity and they very seldom offer problem-solving prescriptions.

The following sections present case studies on household saving for Singapore, Malaysia and China. Some historical economic background is provided together with some trends regarding household saving. Thereafter, a typology table is presented to summarise the most relevant factors in these countries.

3.3.1 Singapore

3.3.1.1 Historical Background

Singapore is a small country (only 642 squares kilometres) with an open economy. Its population is about three million, composed by 2, 7 million citizens and 300 000 foreign labourers (Lee, 1996). After 140 years British rule, the country gained independence in 1965. Its only factor endowment is the hardworking people, however, this nation soon became the success story in the world in just three decades. Today, Singapore is a fully developed industrial economy. The country depends heavily on imports, as there are few natural resources on the island. Its exports and imports are three and a half times its GDP.

In 1960 Singapore was a poor country with a per capita gross national product (GNP) of US\$443. At the time of independence the majority of households were poor and unskilled. However, in 1997, its per capita GNP reached US\$32,940—it was ranked the fourth richest country in the world after Switzerland, Japan, and Norway (World Bank, 1999: 191). Singapore’s rapid economic growth and success have attracted worldwide attention (Quah, 2000:14). Indeed, many political leaders have visited Singapore to determine the reasons for its success and to consider the application of Singapore’s policies in their own countries.

3.3.1.2 Household Saving.

Increased rates of saving: The country succeeded to achieve a major improvement in the living standards of its people through becoming one of the highest saving countries in the world. According to the Monetary Authority of Singapore (2003:55), the gross national saving ratio rose from -3% at the beginning of the 1960s, to 28% in the 1970s and 41% in the 1980s. In the 1990s, the saving ratio increased to 49% and in 2001 declined slightly but remained at 45%. In the case of Singapore, the private saving rates increased significantly over two decades. From 1970s to 1992, private saving were more than double that of other countries in the region. The saving rate increased rapidly from the 1960 till the late 1980s, and then declined at the beginning of the 1990s and increase again in the late 1990s. The following factors contributed to this saving performance:

Demographic Changes: At that time, the working-age population (58%) consisted of individuals aged from 15 to 64 years. This ratio increased from 58% to 70% in the early 1980s and continues to stay so until the next decade (Faruqee and Husain, 1998). In Singapore for example, favourable demographic variables were responsible for the 54% increase in the gross domestic saving from the 1970s through the 1990s. For example, this was true in Singapore where the study done by the Monetary Authority of Singapore (1991) showed that most of the increased saving rate from 19 to 46 percent between 1970 and 1990 was attributed to the declining in dependency ratio.

Economic Growth: More recently, households in Singapore have been able to accumulate a considerable net wealth as a result of high saving and good economic growth (Statistic Singapore, 2004). Furthermore, increased family incomes made possible. According to Dasgupta (2002), “the

economic growth and the associated increase in the demand for labour from 1960 to 1989 raised living standards and sharply reduced the incidence of poverty.”

The role of government

Compulsory savings: Governments in Singapore and Malaysia that enforced compulsory saving schemes, such as social security, enjoy its positive effects on the total rate of private and hence aggregate saving. In 1990, Singapore’s compulsory saving schemes accounted for 25 percent of gross national saving and 11 percent of gross domestic product. As Chandavarkar (1993) put it “the phenomenal rise in Singapore’s national saving is largely accounted for by ‘force-saving’ through the CPF.”

Pension and Provident Schemes: Such government programmes as the construction and sale of apartments and the enrolment of nearly everyone in the Central Provident Fund are to be distinguished from upward mobility, in which individuals moved into more highly skilled and highly paid jobs and hence into higher social classes (Dasgupta, 2002). The Central Provident Fund (CPF) rose from less than 5% in the early 1970s to over 15% in recent years.

Culture:

With a strong spirit of patriotism, Singapore attributed its economic prosperity and political stability to the national culture called “Kiasu”. Kiasu literally means “afraid to lose”. To re-shape the country, the Prime Minister Lee Kwan Yew “captured the hopes and aspirations of Singaporean households with a vision of transforming Singapore ‘from a Third World to First World economy in 30 years’ – the title of his famous book”.

3.3.2 Malaysia

3.3.2.1 Historical Background

The Federation of Malaysia, formed in 1963, originally consisted of Malaya, Singapore, Sarawak and Sabah. Due to internal political tension Singapore left the Federation in 1965. At the end of twentieth century the Malaysian population was estimated at 22 million. According to Andaya and Andaya (2001, 3-4), this ethnically diverse population is composed of 57% of Malays, 24% of

Chinese, 7% of Indians and the rest are indigenous people called bumiputera and non-citizen such as Indonesians, Bangladeshis and Filipinos.

Malaysia is generally regarded as one of the most successful non-western countries to have achieved a relatively smooth transition to modern economic growth over the last century or so. Per capita income growth fluctuated at a rate of 4% per annum during the 1970 - 1980 period. After the recession in the mid 1980s the rate of economic growth averaged 5% (Faruqee and Husain, 1998: 201).

3.3.2.2 Household Saving

As a high saving country, Malaysia has the potential to achieve a higher level of consumption together with the prospect to finance private investment from domestic sources. Whilst household consumption and private investment still is important, it needs to be balanced against the need to save. Its gross national saving ratio in 2002 averaged 35, 4 % of GDP in the last decade. The saving ratio has, nevertheless, remained high at 35% of GDP, but declined from a peak of 42.2% in 1998. The Malaysian saving ratio has declined slightly but it remains at 35% of GDP until 2004 (Aziz, 2004:1). The following factors are important, however, is it clear that the Malaysian government plays a very important role:



Financial Reform and Financial Literacy:

The Malaysian government played a strong supervisory and regulative role in the reform of financial sector. For example, to maintain financial stability, the government intervened by undertaking an extensive programme of gradual deregulation based on elements such as institution building, transparency and responsiveness to monitoring signals.

Public programmes were designed to educate individuals in financial management. Basic information on how to construct a personal budget, the meaning of debt, the various channels of saving mobilization are provided especially to the younger generation. For the lower-income group, financial education programmes were provided to ensure that households would understand the benefits of saving in the formal financial sector.

Compulsory Savings:

In the case of Malaysia, policy designed to provide incentives for households to save, and to provide opportunities for these saving to be held in the financial system resulted in economic growth. The Malaysian government continued to support household saving by keeping through the Merkedda Saving Bond. The Merkedda Saving Bond is an additional avenue and incentives for retirees who are 55 years old and above and do not have a full time job. The launch of the Merdeka Saving Bond in 2004 marked a further step forward in creating new investment instruments for a specific target group of savers who have retired.

Provident Fund:

In Malaysia for example, the Employees Provident Fund (EPF) exhibited an upward trend over the period. The EPF significantly influenced both the saving behaviour and the financial system. Although compulsory saving may impact on voluntary saving, the experience of Malaysia, where national saving rates typically exceed 30%, suggests that *provident funds* may have contributed to high overall national saving rates.

Demographic Changes:

In Malaysia, a shift to the smaller family size and slower rates of population growth played a key role in the creation of an educated work force, while household and government saving increased (Bank Negara Malaysia, 2002). With fewer children, households placed more of their earnings in saving, and governments reduced public expenditures. Because of the falling dependency ratio by 1995, there were 3.1 working - age adults for each child, dramatically reducing the dependency burden and allowing families to save more of their incomes (World Bank, 1993). As families saved more, domestic saving increased to replace foreign funding as the leading source of private sector investment. In Malaysia, the working-age population increased gradually but not to the same extend as in the case of Singapore.

Cultural Factors:

Also, the Prime Minister, Mr Mahatir Mohammed rebranded Malaysia and “captured the hopes and aspirations of its citizens with his Malaysia Vision 2020 and the Multimedia Super Corridor. This

vision of a competitive Malaysia basically sent a signal to all Malaysians that there is nothing they could not achieve if they put their minds to it — the famous ‘Malaysia *Bole*’ or ‘Malaysia Can’ mantra.” Malaysian citizens and its government are net savers.

3.3.3 China

3.3.3.1 Historical Background

China is the third largest country, after Canada and the United States, measuring 4,800 km from east to west, and 3,200 km from north to south, with a total land area of 9, 596,961 square kilometres. It has a population of one and a half billion people, growing at a rate of 0.5%, which means that there are as many Chinese babies coming into the world each year, as the entire population of Switzerland. Of these, 900 million Chinese in the rural area are still awaiting consumer revolution.

Traditionally, the economy of the People’s Republic of China has been characterized by an administration-controlled business cycle known as “grasp” (*shou*) and “release” (*fang*). This characteristic developed as a result of suppressed financial markets under the constraints of the planned economy. Until the mid-1990s, it was still believed that administrative regulation of the business cycle continued to be a distinctive feature of China’s economy. In 1978, almost 20 years since China started its “open door and reform” policy, it had the largest transitional planned economy in the world. More recently, China became the world’s fastest growing economy since its accession into the WTO in December 2001.

In the mid 1990s, the precautionary saving motive became significant due to the increasing uncertainty of future income prospects and the immature insurance market and social security schemes (Franco, 2004:2). Increased saving reduced consumption, and this, in combination with overproduction in manufacturing industries producing television sets, air conditioners, etc., induced a recent deflationary situation in the macro economy of China. China is an interesting case as its transitional economy provides the ideal opportunity to learn how to establish a culture of saving.

3.3.3.2 Household Saving

Similar to their counterparts in East Asia, China’s rapid economic growth can be associated with high saving rates. According to the Economist Reports (September, 2005) on China, its high saving

ratio is close to 50% of GDP. From 1990, its household saving ratio consistently reached over 20% of the GNP although its per capita income remained relatively low. Modigliani and Cao (2004) commented that in 1978, the household saving-to income ratio was below 5%, but this rate had increased to 30% in 1995 competing with the Japanese experience of the 1990s.

China is a huge country with enormous economic diversity (Kuncoro, 2000). China is not only enjoying a saving ratio that is among the highest in the world, but this country has succeeded at maintaining a high domestic saving ratio (Mariko, 1998). As a result of China's high domestic saving ratio, 200 million Chinese were uplifted out of absolute poverty (Francesco, 2004:1).

Economic growth: during the late 1970s, economic reforms resulted in the gross national saving ratio increase to an average of 37% of gross national product, and in rapid economic growth of 8,7% per year in per capita income (Kraay, 1998). It can be assumed that in China too, the high household savings ratio was accompanied by increases in the earnings of the individual as a result of strong income growth in recent years in rural and urban areas in China.

Financial Reforms: During that period (1990s) the development of monetary and non-monetary financial asset markets affected household decisions about consumption and saving, and stimulated the latter during this period.

In China, proliferation of bank branches gave households access to new forms of assets. In urban areas, uncertainty about future benefits and growth of the non-state sector increased the number of urban workers potentially motivated to save for life-cycle reasons. Also in China for example, the reforms in financial markets prompted households to become more positive about voluntary saving.

Demographic Factors:

Higgins (1998) showed that countries such as China and Taiwan also experienced a positive impact on saving due to a low dependency ratio. The heads of households in these countries are mostly saving-aged workers and they may have precautionary motives to save.

In the late 1970s, Chinese authorities adopted a number of reforms concerning the youth dependency trend. Kraay (1998) commented that the introduction of China's one child policy has contributed dramatically to the decline of the population numbers under the age of 14. As a result of these reforms, the dependency ratio pattern changed. Households can now save more than before.

Culture:

For example in China, the Confucian culture and the current one-child-per-family policy motivated Chinese households to save more. As a result of economic reform associated with social and cultural differences, the relationship between financial resources and saving motives have change substantially. This was evidenced in China after the reform that changed the behaviour of Chinese consumers in many aspects (Xiao and Fan, 2002:463). Their studies on ethnic differences in consumption patterns shed some light on cultural differences in saving motives.

3.4 SUMMARY AND CONCLUSION

The East Asian experience of household saving is one of the most remarkable and can provide lessons for other countries (in particular in Sub-Saharan Africa). While the saving ratio showed some variation across nations, the economies of Singapore, Malaysia and China appear to share a common experience of the factors underlying the trend in their respective saving ratios and the direction of those long-run developments. Certain internal factors contributed to the increased levels of household saving. The most important additional factors seem to be financial reforms to suit the specific needs of each country, financial education, special programmes to enforce or encourage household saving and not least, demographic changes and cultural factors

This increase in household saving led to structural changes in the composition of the nation's saving, with implications for improvement in living standards. Though the late 1990s witnessed a financial crisis in the region, results of a strong culture of saving, households continue to save and their saving rates was nevertheless affected significantly.

Whilst not denying the fact that experience from the Asian Tiger's show that poor households can be brought into the formal economy with appropriate monetary and fiscal policy signals it is the channels through which a country embarks itself that motivate this report. This will be examined in

CHAPTER FOUR

SAVING BEHAVIOUR OF LOW-INCOME HOUSEHOLDS IN SOUTH AFRICA

4.1 INTRODUCTION

The South Africa Saving Symposium (2004) cited that: “The deterioration in South Africa’s saving behaviour can mainly be attributed to declines in the saving of households and the general government relative to the GDP. As a ratio of disposable income, net saving by the household sector declined from 5½ per cent in 1992 to an average of about ½ percent between 2000 and the first half of 2004.” South Africa’s extremely low ratio of household saving which began to decline in the early 1980s is an issue which has attracted the attention of many (Aron and Muellbauer, 2000:1). This decline of personal saving as a percentage of disposable income is even worse amongst low-income households.

To fully understand the saving behaviour of low-income households in South Africa and the factors determining their behaviour, this chapter presents a general overview of household saving with a specific focus on poor households. It explains their saving behaviour and debates the role of the informal vs. formal financial institutions.

Section 4.2 focuses on the features of households in South Africa. Section 4.3 gives an overview of the household saving in South Africa. In Section 4.4, the saving mobilization of households in South Africa is explained. This is followed by suggestions of how to building bridges between informal and formal financial institutions.

4.2 FEATURES OF HOUSEHOLDS IN SOUTH AFRICA

The features of households in South Africa are very different due to the very unequal distribution of income and wealth. The following are the most important characteristics of poor households in the country.

Poverty and Unemployment:

Economic science regards households as the final consumers of goods and services and owners of all production factors. But in South Africa, the majority of households are poor and rarely own any assets. These households consist of individuals and families that include also non-government organizations, religious and charitable societies (Fourie et al. 1999: 32).

Size of households:

The average size of households as at the end of 2001 amounts to 3,8¹. The report on a South African survey (2003) of a multi-national study found that: the size of the households ranged from one to 22 persons. According to the survey, most households are black with an average of five members per household, followed by coloured households with less than five persons per household. It was also mentioned that the household size decreases progressively as you move from rural black, to urban black or from rural coloured to urban coloured households. This was consistent with the findings of the research project done by the financial diaries (2005).

Home Ownership:

According to Health Systems Trust (2003), approximately 67% of households were living in a formal dwelling such as a house on a separate stand, a flat in a block of flats, a townhouse or a retirement village in October 1999. The Poverty and Inequality Report (1998) also found that 61% of Africans and 38% of Coloureds are poor as compared to 5% of Indians and 1% of White.

Income Distribution:

¹ Household size refers to the number of people per household.

The unequal distribution of income is of the worst in the world. South Africa's Gini coefficient² has been the highest in the world for a long period (Leibbrandt et al. 1996).

In South Africa, according to Leibbrandt et al. (2001: 22), "the poorest four deciles (40%) of households – equivalent to 52% of the population – account for less than 10% of total income. The richest decile (10%) of households – equivalent to just 6% of the population – captures over 40% of total income."

Illiteracy:

With a population of 46,9 million, most people in South Africa are illiterate, unemployed, and live in rural areas. According to ECIA Africa (2004) 61% of this population is financially illiterate.³

HIV/Aids Pandemic:

Another striking feature of households in South Africa is the high incidence of HIV/AIDS. This has a profound impact on household decision making. The people worst affected by this pandemic are low-income households, mostly living in rural areas (Health System Trust, 2003). These households remain vulnerable due to the loss of income and a number of orphans (dependants) left behind.

4.3 OVERVIEW OF HOUSEHOLDS SAVING IN SOUTH AFRICA

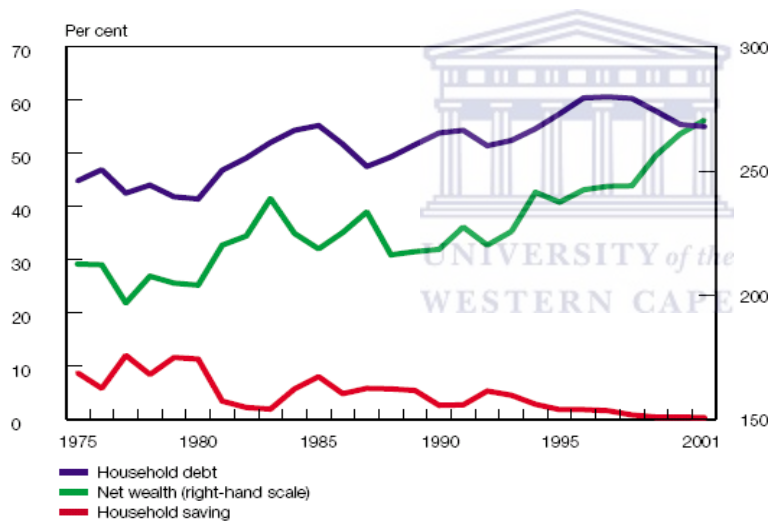
South African households are known for their inability to save. From the 1960s to the 1970s the average rate changed from 11, 4% to 10, 2%, whereas during the 1970s to 1980s, it declined to 4.1%. After the 1980s to 1990 it declined further from 11, 0% to a mere 1, 5% (Mohr and Rogers, 1992: 428). Household saving (equal to the difference between the disposable income of and final consumption expenditure by households) as a percentage of GDP averages only 2 percent in the last quarter of 2005 (SARB; 2005).

² The Gini coefficient has a value between zero and one. The bigger the number, the more inequality exists.

³ "Financial literacy is the way an individual or a family can be changed by a shift in basic habits. It is a basic understanding of banking, savings and the importance of good credit that can allow a low or moderate income individual or family to save enough money to actually buy a home or start a small business."

Prinsloo (2002: 15) confirmed that personal saving expressed as a percentage of personal disposable income declined over the past 20 years. Also Aron and Muellbauer (2002: 2) hypothesized that the offsetting patterns of personal and corporate saving have to do with household “piercing a corporate veil”. It means that if firms retain more earnings; households may save less by a corresponding amount. In such conditions, households pierce the corporate veil and aggregate private saving behaviour will largely reflect household’s behaviour. The decline in household saving is also supported by time-series analyses done by Aron and Muellbauer (2000) and Prinsloo (1994, 2002). According to Reserve Bank figures, household saving as a ratio of household disposable income declined to only 0.2% in 2001, rising marginally to 0.4% in 2002 (See figure 4.1).

Figure 4.1: Household debt, saving and net wealth as percentage of personal disposable income



Source: South Africa Reserve Bank (QUARTERLY BULLETIN December 2002).

Figure 4.1 illustrates the decline in household saving rate from the year 1975 to 2001. The red line shows the trend of the saving ratios. From the late 1970s, the ratio increases tremendously but declines in the early 1980s. In the mid 1980s, saving increase sharply and start to decline again in the

1990s until now where it is close to 0. The household debt (blue line) and the net wealth (green line) continue to increase. This was confirmed by other sources such as Nzimande (2002). He stated that: "South Africa has one of the worse saving records by households in the world, (16% of GDP for the first quarter of 2002) Furthermore, he explains that: some developing countries like Chile, Hungary, Indonesia, Mexico, Malaysia, Turkey and Brazil are all ahead of South Africa in terms household saving ratios.

Although South Africa achieved an economic growth rate of 5% in the first quarter of 2006, the household saving ratio continued to worsen. Jac Laubscher (February 2006) pointed out that "The household saving ratio declined to a mere 0,2% of disposable income, its lowest level since 1952, with household debt increasing to a record level of 63,4% of disposable income by the third quarter of 2005." He also referred to the "Black bourgeoisie" who are educated and rich but lack the culture of saving. This new middle class elite rose their consumption spending but their saving behaviour did not improve.

South Africa's household saving ratio compared to those of the East Asian countries (See Section 3.3) is very low for an emerging economy. It was discuss in chapter three that the average saving ratio of households in the pacific region is around 30%, compared to 2% in South Africa. In Section 3.3 it was said that households in these countries were very poor and could not save in the late 20th century. They managed to reverse the situation by implementing a combination of factors that changed these countries into high saving nations. Can South Africa learn from these experiences?

4.3.1 Saving Behaviour of Low-income Households in South Africa

There is little published literature on the saving behaviour in South Africa. Personal saving as a percentage of disposable income declined since the sixties.

One of the shortcomings of the literature on household saving behaviour in South Africa is that it fails to distinguish between high, middle and low-income households. Much of the literature only considers the saving by high and middle-income households. Assume that the high and middle

income household saving ratios continue to decline over the past year; it can be assumed that saving rate by poor households is then too low or can be even close to 0 or negative in most cases (dissave).

It is often asserted that poor individuals save smaller fraction of their incomes than their more wealthy countrymen because their incomes can hardly support a minimum standard of living.

4.3.2 Factors Affecting the Saving Behaviour of Low-income Households

The worsening saving picture of households can be explained by a number of factors of which interest rates, over indebtedness, high levels of consumption, income distribution, and lack of a saving culture are the most important.

The saving behaviour of poor households depends on other factors than the current or permanent income postulated by the traditional theory (See Section 2.2). In South Africa there are many other interrelated factors than income that are impacting negatively on the saving behaviour of poor households. These factors are discussed as follow:

4.3.2.1 Income:

In section 2.2, the traditional theory postulated that income is the main determinant of saving. However, this income approach has limited application since income in many developing economies is uncertain and cyclical, making estimation of longer-term flows difficult. In South Africa, income inequality amongst races is the highest in the world.

According to Bauman (2001:3), “Income in South Africa, is closely linked to economic status: whilst the middle and upper classes dominate the ‘formal’ economy, the poorest are largely ‘informally’ employed, if at all.” At the aggregate level, poor households receive income from various sources according to their occupation. Research done by the Financial Diaries (2005) provides the background to the income profiles of South Africa’s poor households is shown in figure 4. 2.

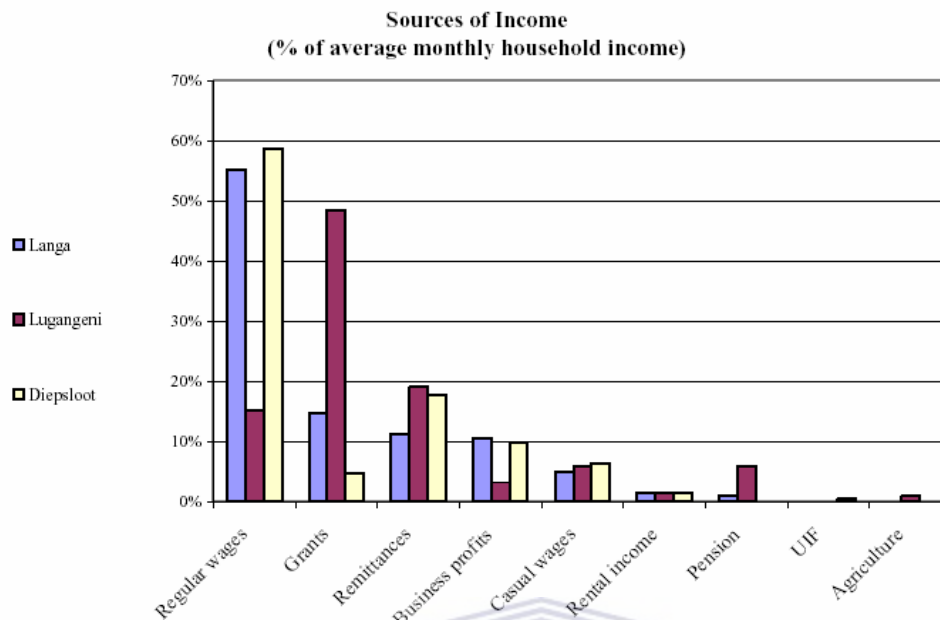
- Regular wages or employment: all income from a permanent employment is usually rewarded on a monthly basis.
- Casual wages: all income from work that is done on a casual basis e.g. part-time jobs is remunerated on a daily basis. The income from this job can be daily, weekly or monthly depending on the arrangement with the employer.
- Business profits or self-employment: Income or profits from a business such as Spaza shops, selling goods from home or on the street (Informal trade).
- Social grants: Income from government paid to the elderly, children under 14 years and those with disabilities.
- Rental income: income from letting a premise such as a room, house or flat.
- Pension payouts: income from a retirement plan such as a pension fund.
- Remittances: gifts in kind or in cash coming into the household from a non-household member (e.g. an aunt not staying in the household). A typical example is the income of a husband working in Johannesburg and who only comes home once or twice a year, is not included as a household member, therefore the money he sends home is taken as a remittance.
- Unemployment Insurance Fund: The dependents of a contributor to the Fund are entitled to the benefits that the contributor would have received if he or she were alive and had become unemployed.
- Agriculture: income from farm households depending only on agricultural production.

Recent research highlighted the fact that at low or subsistence levels of income, the saving ratio is also low. Collier and Gunning (1999) commented that “not only low income in near subsistence level societies, but often tied to highly risky agricultural activities where crop failure can have devastating welfare implications.”

Moreover, these households lack technology⁴ for saving and there is little scope for saving when income is close to subsistence.”

⁴ Households are not exposed to saving facilities such as cards. Booknotes, saving institutions, etc...

Figure 4.2 Sources of Income (% of average monthly household income)



Source: Financial Dairies Study (Daryl Collins: December 2005)

4.3.2.2 Unemployment and Poverty

South Africa's fundamental socio-economic problems are a high level of unemployment and widespread poverty. These social problems affect personal saving directly. According to the government's Poverty and Inequality Report of May 1998, there is a strong correlation between unemployment, poverty and levels of saving. For instance, if 19 million people only have R353 a month to spend, how can they start to save? The problem is worse for those that are not banked or encouraged by low insurance premiums. This poverty trap excludes the majority of our people from saving. Furthermore, financial institutions are not sympathetic towards the poor and thus alienate them from saving in the mainstream of the economy.

4.3.2.3 Consumer norms

Economists and other social scientists have long recognized the importance of reputation effects for explaining patterns of consumption. Consumption norms occur when households or individuals

compete for social status under conditions of incomplete information. Spending to satisfy consumption norms result in the distortion saving behaviour (See Section 2.4.4). These consumption norms are very real among low-income households in South Africa.

(a) Bandwagon effect

Also called a demonstration effect, the bandwagon effect is present in the South African society. As explained by Leibenstein in 1950 (Pindyck and Rubinfeld; 1995: 127) the consumption pattern of a household is affected by the consumption of other households. The bandwagon effect is a consequence of the desire to be in style or to possess a commodity because almost everybody else has it. Leibenstein recognizes people's motivations and therefore considers the desire to behave, buy, dress and consume like others as important. Therefore the investment in social status under incomplete information results in distorted consumption and saving decisions. A typical consequence of the bandwagon effect in South Africa is the utilisation of credit to buy the commodities that other households possess (Silulwane; 2004: 26).

(b) Conspicuous consumption

Here it is assumed that the utility derived from a unit of the product that is demanded for the purposes of conspicuous consumption (i.e. consumption that is clearly visible), is a function of the inherent quality demanded of the product by households is then a function of the real price and the “conspicuous price.” Research done by the financial diaries is consistent with Leibenstein observations. Example in South Africa is label cell phone or fashionable clothing because he or she wants to associate with, have bought these items. Therefore luxurious consumer goods have a ‘demonstration’ effect.

(c) Procedural rationality

According to Post-Keynesians, a different rationality is required: "Such an approach to rationality in case of uncertainty or insufficient capabilities to process existing information, consists of means to avoid complex calculations and considerations, and of procedures enabling decisions to be taken despite incomplete information (Drakopoulos; 1994).

A typical example is the burial procedures by the tradition black South Africans. Roth (2001) provides an illustration of typical funeral costs, which include: Coffin and funeral parlour costs; sheep / cow; cemetery costs; clothes; flowers; taxis; goat; refreshments for pre-funeral prayer meetings; cross; music; feeding and accommodating relatives; administration costs – contacting relatives, receiving payout etc.; photograph enlargement; tent hire; and programmes. He found that the cost of a township funeral varies between R3 760 if no insurance was taken out and R9 640 if an insurance payout was available. Another example is a domestic worker who is a black widow from the Eastern Cape experienced two deaths from Aids last year. She had to give one sister and an uncle a proper burial. She also had to send her two sons to the bush for procedural circumcision. For that ceremony she needed seven sheep for each son.

(d) Gambling illusions

Addiction to gambling causes household members to dissave. The ratio of gambling costs to net income has been found to be significantly high in South Africa. Low-income households may use part of their income to buy lottery tickets or to play poker in a Casino. According to the Study Commissioned by the National Gambling Board of South Africa (Pretoria; 2003), “Gambling money is displayed from variety of items ranging from necessities to dissaving”. Also South Africa is rated exceptionally high in world gambling terms. Cases were also reported where the head of household resigned from his permanent job to gamble. (Personal Interview: 15 November 2006). Often a person would be lucky the first time and then gambles more and more in order to win again and eventually loses control.

4.3.2.4 Over-indebtedness of Households

High debt impacts on households' ability to save and to accumulate assets. Household indebtedness is increasing amongst the poor in South Africa (Silulwane; 2004: 41). IOLS (2003) and Financial Diaries (2004) researches found that the saving potential among workers was very low resulting from their spiralling debt, low take home pay and the increase in the cost of basic necessities, such as food and school fees. 52% of the respondents of a survey did not have any saving or investments, while 48% had saving of between R100 and R400 (Bayat; 2003). Although, in general, the macro

picture on household indebtedness in South Africa reveals that household debt is declining (Schussler; 2003), over-indebtedness of poor households make them the victims of unscrupulous loan sharks and consequently reduce their ability to save or acquire assets.

4.3.2.5 Dependency ratio

The number of dependents (or non-income earners) is another important factor that determines the saving behaviour of poor households. (See Section 2.4.2.) Households with non-earners are a burden and cause an increase in household expenditure, thus lowering their saving potential. As Trevor Manuel (2004) said in his speech: “the worsening saving picture for households can be explained by a number of factors, principal of which are the growing dependency ratios.” However, the dependency ratio does not tell the complete story (Personal Interview: 16 November 2006). The financial expert mentioned the experience of the banking sector where they cannot judge the ‘normal household’s household ability to pay, when considering whether somebody will be able to pay off a loan.

4.3.2.6 Economic and Social Exclusion

Leibbrandt *et al.* (2001: 21) commented that: “the dominant themes of South Africa’s economic history are inequality and exclusion. Poor people in this country have been excluded from participating in the economy. They also suffer from social exclusion due to the legacy of the past. These include negative attitudes on the part of predominantly white management under apartheid (Eberson and Ryan; 1991)⁵, the image of austerity associated with formal institutions, as well as the failure of banks to offer services in the vernacular (Cross; 1987). The apartheid government implemented policies that were favourable only for the white population. Some of these policies included job-reservation; the demarcation of group areas according to the race and vertical mobility. Honesty and trust plays a major role in the study of saving. Economists suggested that higher trust between people in a population should be associated with greater cooperation. In South Africa, poor households still do not trust the formal financial institutions as a result of social exclusion. Trust or

⁵ The authors quote a senior building society executive as saying, 'Frankly, we don't want the gumbboot brigade in our banking halls' (1991: 39).

social capital determines the performance of a society's institutions. Trust can be defined as the propensity of people in a society to cooperate in order to produce socially efficient outcomes and in this way avoid the inefficient non-cooperative traps such as that in the prisoner's dilemma (Fukuyama, 1995). Also Durlauf and Fafchamps (2004:9) pointed out that generalized trust, which leads to a higher level of efficiency, is often accompanied by a climate of sustainable socio-political responsibilities.

4.3.2.7 Lack of financial literacy

An extremely low financial literacy level in South Africa is an important factor of dissaving and indebtedness by poor households in. According to the World Competitiveness Report (2003) South Africa rates as the lowest in economic literacy out of 49 countries surveyed and as the second lowest in financial education. It is important to realize that the lack of education of low-income households determines the quality of their financial decisions. The financial illiteracy can result in information asymmetries and consequently in inefficient decisions. For example, a person who cannot read a bank statement or is not familiar with the financial services/products will suffer the consequences of information failure⁶.

4.3.2.8 Unforeseen circumstances or shocks to households

An unexpected shock or event such as death or illness may cause the households to save less or may be forced to stop saving and consequently end up dissaving. Sometimes the income or savings of the household may not be enough to cover the total cost of a funeral (Silulwane; 2004: 24). As a result they are forced to borrowing. The position of these households can worsen if the deceased was a breadwinner or suffers from AIDS. When one of the members of a household begins to suffer from HIV-related disease the whole household experience the economic impact of HIV. A study by Booyens, Bachmann, Matebesi & Meyer (2003) indicates that households affected by HIV/AIDS are significantly poorer than non-affected households. Affected households are more likely to have used some of their savings and where unaffected households used some of their savings, affected households used a larger proportion of it.

⁶ Information failure as a result of not meeting the demand of the commercial bank.

4.4 SAVING MOBILIZATION OF HOUSEHOLDS IN SOUTH AFRICA

Financial access also matters with regards to saving. In South Africa, the saving facilities available for the poor include formal institutions such as postal banking, commercial retail banking and informal institutions like the ROSCA's. Also, Bauman (2001:1) pointed out that "South Africa's highly skewed income distribution and economic structure contains a large number of so-called 'unbankable' households." Asraf *et al.* (2003:2) argued, "...low saving might be a consequence merely of poor access to safe, flexible, convenient, and affordable saving products." The following sections discuss focus on these institutions.

4.4.1 Formal Financial Institutions

The financial sector in South Africa is generally recognized as world class because of its skilled workforce, adequate capital resources, infrastructure and technology, and a conducive operating, regulatory and supervisory environment (NEDLAC; 2002: 1). South African banking regulations rank with the best in the world. The sector has long been rated among the top 10 globally. There are 55 locally controlled banks, 12 foreign-controlled banks and five mutual banks. Some of the world's leading institutions have entered the local banking sector through mergers and acquisitions.

In the formal financial sector, there are two institutions available for the mobilization of the saving of households. These are Postal banking and Commercial retail banking.

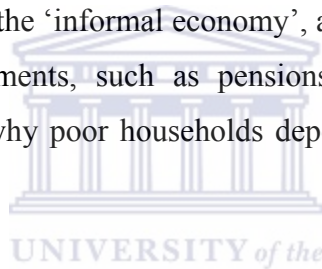
4.4.1.1 Postal saving

The Post Office Saving Bank (Postbank) is a deposit receiving institution, but not a fully-fledged bank. The Postbank does not provide credit to the public, whether from its own sources, from funds received from other persons or from self-generated funds (Fourie *et al.* 1999). According to Fourie *et al.* (1999: 93), the Postbank provides saving facilities in the form of saving accounts, which is the main service offers by the Postbank. It offers a telebank, which is a card-based saving facility, used specifically by employees of the Post Office, Telkom and some Government departments. The Postbank also offers a saving certificate, which offers depositors tax concessions.

4.3.2.2 *The Private Banking Sector: Commercial retail banking:*

The South African banking industry is dominated by large commercial banks due to the main emphasis of its business (service). According to Fourie *et al.* (1999:89), commercial banks comprise high volume of notes and small change and sleeping and gainless asset due to their various branch networks and a large number of smaller rural branches. ?????

According to Aron and Muellbauer (2000), financial liberalization has been the main cause of the decline in household saving. The distortion of the financial system in South Africa is partly due to the legacy of apartheid. The South African retail banks were focused at serving the white population previously. Poor or low-income households coming from the secondary economy were marginalized and unbanked. According to Bauman) 2001:2): “The commercial retail-banking sector cannot profitably serve such households, which exist within the ‘informal economy’, and depend significantly for cash income on state transfer payments, such as pensions, and affective transfers from employed relatives.” That is why poor households depend and rely largely only postal banking and ROSCA’s.



On the other hand, these households in return could not afford to pay the basic fees required by the formal financial institutions to sustain their costs. According to the Personal Interview (16 November 2006), it was found that not only are high transaction costs deterrent, but poor households do not want to pay for financial services. This is mostly due to the impact of financial illiteracy and their mistrust in the financial system. It should also be remembered that a culture of non-payment was created as part of the struggle against the apartheid system. Beside the fact that the apartheid government supported a financial sector clouded with inefficiencies, the financial sector was also highly concentrated and limited competition was allowed (Finscope, 2003).

Since the democratic government has come to power in 1994, the financial sector has deepened and many financial services are now available to previously disadvantaged South African. New institutions were born – wholesaling financial support, the National Housing Finance Council (NHFC⁷) and Khula Enterprise Finance (Khula). However, according to speculation in the media, all these institutions have not been successful.

SASI (The South African Savings Institute) was created in 2001 and aims to play a catalytic role in the improvement of savings in South Africa, particularly savings by the household sector through channels such as advocacy, research, information exchanges; roundtables and savings promotion. However, after five years of existence, household savings as a proportion of GDP continue to decline in South Africa (Masilela, 2006).

In 2003, the Financial Sector Charter was launched. The aim of this charter as described by Kirsten (2006: 4): “The Charter embodies an agreement among the major players in the financial sector – banks, insurance companies, brokers and exchanges – on a set of service provision and empowerment targets in such areas as banking services to low income populations, black employment and ownership in the financial sector, and support for black entrepreneurship. All financial services companies are expected to pursue these targets, to report periodically on their progress to a monitoring body set up under the Charter, and to be graded on their performance in the form of a public scorecard.”

As a result of the initiative of the Financial Charter, the Mzansi bank account was created to extend banking services to low-income earners and those living beyond the reach of the banking services (Kirsten: 2006). This account can be opened at any of the major four retail banks in South Africa with the ID.

⁷ The National Housing Finance Corporation (See Government Sponsored Entities, above.) The National Housing Finance Corporation (NHFC), <http://www.nhfc.co.za/>, is a wholesale financier that funds housing lenders so that they may on-lend to end-users with monthly incomes of up to R6000. End user loans are secured either by mortgage or by some other form of security (such as the borrower’s pension-provident fund withdrawal benefit). Interest rates are not subsidised, but priced appropriately for risk.

The South African financial sector still faces many challenges and despite efforts by the government to regulate and facilitate the financial sector, it still largely fails to provide essential financial service directly to the marginalized poor. Informal institutions such as ROSCA's are trying to meet some of the needs of the poor black.

4.4.2 Informal Institutions

Various explanations have been proposed to account for the reluctance of black savers to utilize formal sector banking instruments. However, such arguments do not adequately explain why ten years into democracy informal saving are still preferred to formal financial institutions, or why individuals choose to save collectively rather than under the mattress. There is a fundamental shortcoming in existing South African literature on informal saving, which largely points to the benefits of participation but neglects to explicitly address why alternative instruments are not employed.

In Section 2.5.3 a vast source of literature on ROSCA's was discussed. Although ROSCA's are operating informally in many developing countries, they remain a form of saving mobilization mostly for the poor. In South Africa, the Unilever Institute (2003) estimates that informal saving groups are at 5.61 billion annually. This is a conservative assessment in the light of other studies that suggested that this amount is in excess of R20 billion. It is not entirely implausible given estimates that almost every second black adult in South Africa participates in an informal saving scheme (Unilever; 2003), whilst the saving propensity is high amongst stokvel members (Verhoef calculates average saving rates at 10% of income (2000b: 535). This is undoubtedly very significant consider the fact that informal saving groups continue to flourish alongside a sophisticated formal financial sector.

In South Africa, conventional wisdom holds that "stokvels" or informal saving group are simply a means for the poor to mobilize financial resources in the support of developed financial markets. More specifically, stokvels are groups of people who save collectively and provide different services to one another. It is important to note that stokvels are rotating saving and credit associations

(ROSCA's) in which members make contribution and are entitled to receive a lump-sum benefit on a rotating basis. This contribution varies between R50 and R100 per month.

Stokvels are not the only informal voluntary saving organizations in South Africa. There is also saving organization such as SACCO, saving cooperatives, burial societies etc. Only stokvels and burial societies will be discussed in the following sub-sections.

4.4.2.1 Stokvels

The existence of stokvels is recorded as far back as the 1880's. The word 'stokvel' comes from the term 'stock fairs', which had its origin in cattle auctions held by British settlers that took place in the Eastern Cape at the beginning of the nineteenth century. Rural black communities adapted it as the term to designate or describe their rotating saving and credit activities. Most stokvels have a constitution (verbal or written) and their leadership generally comprises of 2 or 3 members to control the finances and the functioning of the society. The majority of stokvel member are women.

The National Stokvels Association of South African (NASASA) estimates that there are 800 000 stokvels in South Africa. According to Finscope (2003), 2,5 million adults are members of stokvels. They also found that 8% of unbanked and 14% of the potentially banked are members of a stokvel. This is an indication that stokvels provide their members with benefits that banks do not provide or are unable to provide. Such benefits include risk mitigation (Insurance Scoping; 2005). The history of stokvels illustrates that their social purpose is as important as their economic purposes.

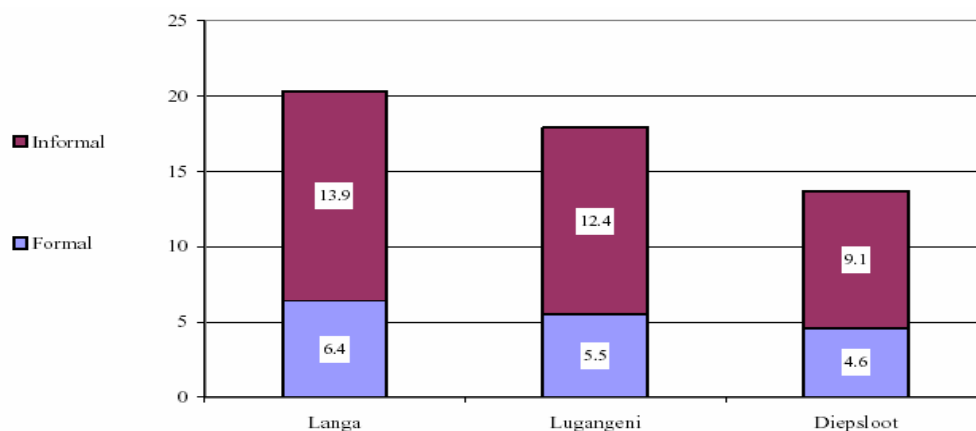
Stokvels can take on a number of forms, most of which include a saving or loan (credit) component as well as an element of social interaction. Stokvels rely on UBUNTU principles or reciprocity and mutual trust for their sustainability. The African concept of "*ubuntu*", which means caring for each other's well-being in a spirit of mutual support, forms the basis of the establishment of new social networks aimed at assisting people with adjustment to the urban environment. "Ubuntu" is the humanistic African cultural ethic, based on the human being and connections between people. It is a collective consciousness, a shared experience of e.g. deprivation or poverty, which leads people to provide mutual support (Verhoef, 2002). Furthermore, the ubuntu concept emphasizes strongly on

the significance of the group for survival issues. Berger (1996) argued that fundamentals of ubuntu are caring and sharing. Also Helman (1950) asserted that the informal voluntary organizations, although not always mono-ethnic, often acted in the spirit of “ubuntu”, as mechanisms to bridge tribal and ethnic divisions towards facilitating a social support network.

There are many types of stokvels. Verhoef (2002) identify different categories of stokvels such as saving clubs, investment and credit groups, high-budget stokvels; etc. UCT Unilever Institute of Strategies and Management Studies (2003) also finds that stokvels can be distinguished according to their purpose. According to Thomas (1991), Buijs and Atherfold (1995) and Moodley (1996) case studies research indicated that stokvels were the instruments of Africans’ communal response to conditions of poverty and relative deprivation.

Furthermore, Collins (2005) conducted a research on the financial instruments available to the poor, using data from the Financial Diaries Project. It was found that households use an average of 17 financial instruments. The majority of these are informal financial instruments (see figure 4.3). This phenomenon can be explained by a continuation of both historic trends as well as development of new manifestations to respond to modern environment (Verhoef; 2002). Thus, a strong relationship exists between the social security and economic survival functions of the “stokvels” in South Africa.

Figure 4.3: Average Number (Formal vs. Informal) of Financial Instrument used during the study year



Source: Financial Dairies Study (Daryl Collins: December 2005)

4.4.2.2 Burial Societies

According to Thomson and Posel (2000), “Burial Societies are member-based financial institutions that provide funeral insurance to their members and have their origin in the economic and social pressures arising from migration and urbanization.” Verhoef (2002) claimed “burial society or second type of “stokvels” ensured that the traditional practice of a dignified funeral was not undermined by the social and economic dislocation of African community by urbanization and industrialization.”

However, in South Africa, burial societies are member-based, non-profit financial institutions that primarily serve as a means for members to save for and insure themselves against the cost associated with the lost of a family member. In African culture, the funeral of a family member is an opportunity to reaffirm the bonds of a relation within its particular community and a dignified funeral is thus required. An animal is generally slaughtered and a large celebration is held, which can be quite costly.

Burial societies operate like stokvels. In South Africa, almost 8 million adults are members of approximately 100.000 burial societies. The National Association of Burial Society of South Africa (NABSSA) estimates that the average burial society has about 88 members. According to Finmark, identified two types of burial societies:

- “Collection: funds are collected from members as a death occurs
- Pre-funded: Member’s contribution on a monthly basis and claims are paid from the accumulated funds.”

4.4.3 Linkages Between Formal and Informal Institutions

Though stokvels and burial institutions operate informally, they have linkages with the formal financial institutions. Burial societies seem to have well-developed links with banks just like stokvels. Research done by Finscope (2003) showed that approximately 75% of stokvels have a group saving account (under the name of the club/society), 14% have an individual account at the bank (on behalf of all members) and 4% have an account at Postbank. Therefore, low-income

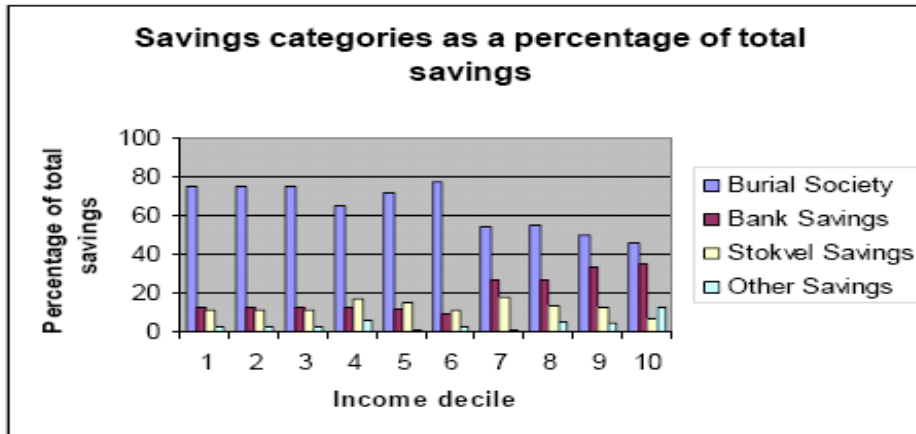
households are linked in this way to the formal financial institution via the stokvel. Unilever Institute (2003) estimates the value of this link at R5.61 billion. The financial aspects of these saving associations are undoubtedly significant.

The stokvel and burial society culture at the lower end of the market proves the existence of a willingness to save, even in the absence of large amounts of disposable income. It is therefore, up to the financial institutions to provide the relevant products to transform this willingness to save with the purpose of longer-term wealth.

Although these informal institutions continue to persist alongside formal financial institutions, they suffer from several weaknesses and do not remove the need of formal sector financial services. Indeed Arlington and Leibrandt (2004: 2) commented, “to a large extent informal saving groups and formal financial services are complementary.”

Informal saving mechanisms are useful, but they do not remove the need for formal services (Vonderlack and Schreiner, 2001: 33). The question is what the formal services offer that is not catered for by the informal services. Figure 4.4 below shows what percentage of total saving went to specific saving instruments. It indicates more informal saving instruments are in use than formal banking instruments. Figure 4.3 illustrates to what extent informal and formal saving instruments are being used for personal saving. Burial society saving takes up a larger proportion of total saving for poorer people. As income increases, the proportion of burial saving to total saving declines. Bank saving as a proportion of total saving increases with an increase in income. Stokvels take up an equal proportion of total saving regardless of the income level. The use of other saving forms seems to become popular with people in the top two income deciles of the population.

Figure 4.4: Saving Categories as a Percentage of Total Saving



Sources: Porteous and Ross Esson (2003: 16).

Verhoef (2001b: 537) finds that almost 90 percent of stokvel participants also have a personal bank account, but draw on this facility infrequently, with only 2,3 percent using an account to earn interest. There is evidence that those individuals perceive these networks as having value in excess of their saving function. Also, group saving allows households to increase their social capital, by participating in a community action.

In the literature about informal saving mechanisms in South Africa, the role and functioning of the stokvels has not been systematic. However, research based on case studies can reflect their role and importance. The South African situation is unique, taking into consideration the continued existence and functioning of ROSCA's compared to international experience. The first argument is that South Africa is a middle-income, not a low-income country because of its strong and sophisticated first world economy. Secondly, the financial system in this country is highly sophisticated and cannot be compared with the financial intermediaries of the rest of Africa. Why do informal saving mechanisms continue to exist? Furthermore, some members of stokvels are also holding a bank account and are not always part of low-income groups. The Financial Sector Charter (2002: 5) asserted that a large amount of funds circulates outside the formal financial sector.

4.5 BUILDING BRIDGES IN ORDER TO CREATE A SAVING CULTURE

On the ground of these findings, one conclusion that can be drawn is that there is a need for an inclusive financial system for all. Different financial institutions have different effects on households saving, therefore some institutions may be more efficient in increasing the ability and capacity of household to save effectively while others may specialize in lending facilities. This means that a variety of financial service providers are required to meet poor clients demands (Helms, 2006: 35). All the role players have to respond positively to this proposition. According to a Personal Interview⁸ (November 2006), government and the financial charter have already proposed solutions to this problem but nothing has been implemented yet.

4.5.1 The Role of Government

Government is the major role player in any country. The strong role of the government in ensuring a favourable environment within which microfinance can flourish is important. It is the responsibility of the state to identify appropriate role players (Employers; Representative of Board of Trustees; Government; Labour Union, NGO's) to implement and manage a long-term saving industry. Government should also focus on the poor. For example: not all the poor should be qualifying for subsidies. People earning less than R3500 per month should be the target market for subsidies. Therefore subsidies, which guarantee to free the money, should be replaced (Personal Interview; November 2006).

Government should enforce compulsory saving as a vital solution. South Africa can therefore learn from the experience of Singapore and Malaysia as discussed in Section 3.3. Lastly, government should promote financial literacy. People should be committed to life-skills education. Children and adults need to learn about financial principles, risk mitigation, property rights etc. The focus should be on educating children. Financial literacy programs should be included in the education curriculum. Teachers should upgrade their financial knowledge through workshops and seminars.

⁸ Interview with a Financial Expert retired from Rand Merchant Bank.

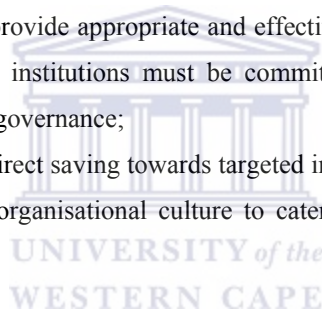
For adults, financial literacy programs must be design and available via radio, television, billboards, public places and also included in adult basic education programmes (ABET). In order for these programmes to be effective and efficient, al stakeholders (households, banks, insurance companies, media, government, NGO’s) should be fully involved.

Also, government should address the problem of exceptionally high consumption expenditure behaviour by households. The South African government should learn from the Chinese experience as discussed in Section 3.3.2. In order to promote saving, government should stimulate financial access particularly for the poor households and promote long-term saving.

4.5.2 Working Together with the Private Sector

Understand past and risk. In this sector, all the participants are invited to show their sensitivity. For example the financial sector charter objectives should be practical. Some these objectives are:

- The financial sector should provide appropriate and effective access to financial services for a greater segment of the population. Financial institutions must be committed to triple bottom line accountability, including principles of good corporate governance;
- The financial sector should direct saving towards targeted investments of national priority. Financial institutions should adjust their internal organisational culture to cater for a wide range of customers and to reflect the principles of inclusively.



4.5.3 The Role of Supporting Institutions

It is necessary to build bridges between formal and informal financial institutions to assist in saving mobilization. This can be done through the existing institutions such as (i) the National Housing Finance Corporation (NHFC⁹) where part of process of expanding the benefits of housing development includes building a savings momentum. Should savings group (Stokvels) reach a point where they themselves begin to organise others, training and other transaction costs would be greatly reduced. Moreover, encouraging

⁹ The NHFC’s main contribution therefore is that it has made housing finance accessible to low income households who cannot access private finance because of high risk perceptions. The fact that Stokvels have been used in some communities as housing savings groups, and members have also assisted each other in the house building process, together with the NHFC, they can support each other.

communities to save would help to develop intra- and inter-community support networks, and promote a sense of collective action, which could lead to additional resources being injected into savings systems. This should take place both to prevent the fund from becoming over involved in the process to the detriment of its main aims, and to foster a sense of community accomplishment. (ii) The South African Settlement's Trust initiated by government, the private sector and Pension Funds (Personal Interview; November 2006). (iii) The South African Revenue Services to mobilize compulsory saving. (iv) The utilisation of the Postbank should be encouraged. During the 1950's, white children were encouraged to save at the Post Office. Their primary school did the administration of the saving scheme. According to a Personal Interview (November, 2006), children could buy stamps to put into the saving book and once it was full, these children were very proud. Consequently they became actively competitive to get their book full. Can this type of saving be re-implemented? Postal savings can be an important mechanism for the mobilisation of the financial resources that can be applied for domestic development. To save in the Postbank is more popular should the general public's distrust of bank rises or when there is unusual of political anxiety or economic insecurity. The Postbank is also within easy reach of households in the most remote areas of South Africa. (See the experience of the Asian Tygers.)

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According to SASI (2006), to promote a saving culture, the determinants of the determinant of saving here are more structural in nature and include amongst other:

- i. "Raising income levels of South Africans;
- ii. Reducing dependency ratios, to allow free income for saving purposes;
- iii. Changing mindsets;
- iv. Reducing information asymmetries;
- v. Increasing access through the development of appropriate institutions, which would involve affordability, geographical reach and appropriateness of products..."

4.5.4 The Importance of Implementation

Designing a saving model for South Africa without application would never work. The right people and the rights institutions (See Section 2.5.2) should be involved. Stakeholders should be committed to risk mitigation. As Paul Kagame put it "In Rwanda, I have suggested that the only drawing board I am interested in is that of implementation.

CHAPTER FIVE

GENERAL CONCLUSION

In the built up to this descriptive investigation, it was clear that the traditional theories of household saving behaviour do not really explain the saving behaviour of low-income households in developing countries. It is also clear that the majority of poor households have the potential to save but do not have access to formal financial institutions due to conditions governing the financial services offered. Newer theories relating to the bandwagon effect, conspicuous consumption and, procedural rationality together with the use of flourishing informal saving mechanisms were found useful in explaining the reasons behind low saving ratios of these households.

It was mentioned that most empirical evidence emphasized that income is the main determinant of saving which seems unlikely in the context of a developing Sub-Saharan African economy like South Africa. Empirical investigations also show that the dominance of other factors than income, informal saving institutions coupled with their motives and a social financial exclusion, contribute to the low saving ratios of poor households.

Some countries have successfully created a culture of saving amongst poor households and continue to enjoy the benefits associated with a high saving ratio by households. These countries (i.e. Singapore; Malaysia and China) used combined policy approaches that one can learn from.

An importing question that emerges from these findings is why informal saving continues to be ignored by the formal financial institutions. This possible complementary relationship between informal and formal financial saving is suggested as a topic for future research.

A number of policy implications have been highlighted. The main theme is that efforts to commit the role players to the development of a saving culture should be routed through boosting saving for all.

Also, the report recommends the sustenance of reform efforts that will increase household participation and de-emphasize government subsidies in saving activities.

Finally, it has to be emphasized that these results should be treated with caution. Firstly, generalization is not advisable at this stage as further research would be required for other developing economies to confirm or refute the claim made in this report. Secondly, severe limitations of the official data of the low-income households and the South African government agencies used in some of the estimates may mar the robustness of conclusions drawn here. Finally, problems of interpretation of the qualitative approach used in the study are acknowledged and temper the conclusions drawn in this report.



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