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Methods of Increasing the Rate of Saving

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Introduction

The problem of increasing the ratio of savings to income in order to finance the investment needed for sustainable economic growth is one that has been studied extensively in the postwar period.2/ These studies have not produced a consensus that any single, or group of, savings instruments or institutions will automatically guarantee a significant expansion in the savings ratio. On the contrary, it has usually been stressed, and correctly so, that the particular savings instruments and institutions must be those suited to the economic and social environment of the area.

There also appears to be general agreement on two points. If the domestic savings sectors are viewed as being comprised of households, business, and government, the general tendency in the underdeveloped countries is for the household sector to be a net supplier of savings with the other two sectors net receivers.3/ This suggests that the quality, and possibly the volume, of saving is enhanced if there are appropriate institutions and instruments to facilitate this process.

A second point is that those countries with a high ratio of savings usually have a high ratio of financial assets to tangible assets. 4/ In other words, in the high-savings economy, a larger proportion of savings, particularly in the household sector, takes the form of financial assets such as savings accounts and securities, and a lower proportion takes the form of tangible assets such as land, farm equipment, irrigation facilities and housing. There is some question as to which is the cause and which the effect, but it is quite possible that efforts to expand the proportion of savings placed in financial assets may help increase the rate of saving. As with the problem of inter-sectoral transfers indicated above, the introduction and development of appropriate savings institutions and instruments is very important for promoting this process.

Altogether there are three possible ways of influencing the volume and/or quality of saving in an economy. The approach first indicated -- involving changes in the form of savings -- is not particularly dramatic, but may offer the best way in the final analysis. The other alternatives involve either: (1) producing a larger absolute volume of savings as income rises but the savings ratio remains unchanged; or, (2) increasing the proportion of saving at the expense of consumption. Naturally, some combination of these alternatives is also possible.

1/ This paper was prepared for the Seventh Meeting of the Central Bank Technicians of the American Continent, Rio de Janeiro, Brazil, October 1963.

2/ The Economic Commission for Asia and the Far East has sponsored various studies of this problem. A list of the saving studies in seven Asian countries and a special article on the results of these studies is contained in the Economic Bulletin for Asia and the Far East, Economic Commission for Asia and the Far East, Bangkok, December 1962.

3/ Ibid., p. 24.

4/ Ibid., p. 8.

A study of savings ratios in Latin American republics between 1953 and 1961 indicates that only in a very few countries was there evidence of a definite uptrend in the savings ratio. While eight years is a relatively short period for substantiating this hypothesis, there is at least a presumption that country savings ratios do not tend to increase steadily over the years. A comparison of the savings rates between industrialized and underdeveloped countries reveals that both groups contain countries with high as well as low rates of saving and the evidence is by no means conclusive that high per capita incomes guarantee a country a high savings rate.

In connection with the hypothesis stated above, it is helpful to examine government policies related to the promotion of savings as well as the institutions and instruments through which these policies can be effectuated.

Savings Institutions

Although the world has a wide variety of savings institutions, their number and variety is rather limited in the less developed countries. The mere growth of these institutions in the less developed countries is probably not as important as the growth of the right kind of institutions. This is because their success is highly dependent on their appropriateness for the particular social and economic environment of the area. Not only are there likely to be differences between countries, but also between urban and rural areas. So far relatively few studies have been made of this problem and it would appear to be an area that could be investigated profitably in greater detail, perhaps leading to innovations in the savings field for some countries.

As indicated earlier, it may be possible to make progress in increasing both the volume and efficiency of saving by changing the form of saving. By increasing the proportion of savings placed in financial assets, as opposed to tangible assets, a more efficient use of resources becomes possible. It is in this area that the development of savings institutions can play a major role. This involves expanding existing institutions, reducing or eliminating others, and introducing new institutions.

One of the ways in which financial assets can be made more attractive to savers is to have the government provide insurance for various types of savings accounts and deposits. The United States has pioneered in this field, providing insurance for both bank savings accounts and shares in savings and loan institutions. In recent years less developed countries have shown some interest in deposit insurance. India, for example, introduced on January 1, 1962, a plan insuring bank deposits up to 1,500 rupees, equivalent to US$315. This action was taken after the failure of a major bank shook depositor confidence. The Philippines inaugurated a deposit insurance system in 1963.

Another method for reducing savers' fears is to make available to investors attractive securities which are either issued or guarantied by the government. Of course, the issue by government-owned corporations of bonds guarantied by the government is a well-known practice in the less developed as well as the developed countries. Japan went beyond this in the early stages of her development as a modern industrial power. The Japanese Government guaranteed the maintenance of specific rates of dividends on the equities issued by a limited number of private corporations. For example, in 1885, the Government pressured two private competing shipping companies to merge and form the Nihon Yusen Kaisha. The Government provided a guarantee that the dividend of the new firm would be maintained at 8 per cent for a period of 15 years. This type of guarantee had the advantage of giving the saver the inducement of a good fixed rate of return as well as the possibility of capital gains.5/

Some of the traditional savings institutions appear to be better suited for the less developed countries than others. It is not economically feasible to establish branches of regular commercial banks in all of the small rural towns and villages, but a system of efficiently managed cooperatives could provide adequate facilities for savers. A network of various types of cooperative organizations has operated successfully in industrialized Japan for many years, providing not only outlets for savings but also small loans. It is important, however, that the cooperatives be based on sound financial charters and the personnel be adequately trained in lending, accounting and other basic financial principles.

Some countries, including Malaya and the Congo (Leopoldville), have experimented with mobile savings banks in rural areas, but the results have not been too encouraging. Savers appeared to favor savings outlets located in permanent structures.

Investment or development banks are a relatively new phenomenon for the less developed countries, but would appear to have a promising future. With a well-trained staff, an investment bank is able to ferret out sound profitable projects, mobilize the necessary financing, and provide helpful advice to the management on financial and other problems until the firm is able to operate successfully by itself. By engaging in underwriting activities, the bank could also expand the scope of the capital market and thereby broaden the possible outlets for savers.

Two of the more important savings institutions in the government sector consist of retirement programs and postal savings. Since the payments into the retirement or provident funds are largely compulsory for government employees, these funds constitute a substantial proportion of government-mobilized saving. Government-decreed increases in these contributions would be one method of directly expanding the flow of savings.

Postal savings accounts and certificates have been available in most countries for many years but the growth of these accounts has been modest. This is primarily because of the low interest return. In some countries, such as India, there are indications that this outlet for savings is becoming less popular, not only because of the low yields (2-1/2 to 3 per cent), but also

5/ Keizo Shibusawa, Japanese Society in the Meiji Era, Obunsha, Tokyo, 1958, p. 375.

because of the restrictions and long maturities (15 years). In Malaya, postal savings also lack popularity, but rather than raise the interest rate on these investments, the Government is attempting to make them more attractive by other means. Even in Japan, where postal savings deposits have long been one of the most popular forms of saving for people of modest means, there has been a decline in their popularity in recent years. Postal savings deposits as a percentage of total time and savings deposits in the country fell from 17.5 per cent in 1953, to 11 per cent in 1962. This probably reflects the greater flexibility and aggressiveness of private savings institutions in competing for deposits. Postal savings have so declined in popularity in the United States that serious thought has at times been given to discontinuing them. This is because of the very low interest rates paid, less convenient methods of handling deposits and withdrawals, and the growth of public confidence in banks and other savings institutions.

Recently there are indications of government interest in expanding the volume of insurance for government employees. In India and Malaya compulsory insurance plans have been introduced. Because of the compulsory aspect, these plans are expected to generate an additional amount of new savings.

More indirectly some governments have promoted through various devices public interest in investment companies. In Austria and France, such companies included government enterprises in the initial portfolio in order to foster investor confidence. In Mexico, shares in investment companies have been marketed by Nacional Financiera which not only included various government enterprises but also a guarantee of the interest yield on the investment.

Other savings institutions in the private sector include savings and loan associations, mutual savings banks, insurance companies, the securities markets, and credit unions. There is substantial room for the development and expansion of savings and loan associations in most of the less developed countries and the U.S. Government is interested in assisting in this endeavor.[6] Securities markets in most underdeveloped countries need to be broadened and this would involve, among other things, promoting the full, honest and frequent disclosure of a company's financial condition, developing secondary markets for securities, providing special redemption facilities where there are fears of illiquidity, and shifting local preferences for investment in commerce and real estate to industrial ventures. The Japanese have had outstanding success in developing an interest in equity investment among people with relatively low incomes. One device which securities companies have used is to provide so-called "million yen boxes" in which the householder deposits cash which he wishes to invest. An employee of the security company periodically comes around and collects this. In some countries arrangements have been made for employees to buy securities on an instalment plan basis. Other methods of promoting savings include payroll savings schemes, incentive plans, and school savings schemes [7]

6/ See "Establishing Savings and Loan Associations in Less Industrialized Countries," Housing and Home Financing Agency, March 1958, Washington, D.C.

7/ See Incentive Savings Plans, 1960, and School Savings Banking, 1963, American Bankers Association, New York.

Besides the establishment and development of savings institutions, the introduction and use of various savings instruments is important in the promotion of savings.

Savings Instruments

From the viewpoint of promoting savings, the important aspect is to have instruments that are easily accessible, relatively simple in form, and appropriately designed to meet the savers' basic objectives. This last goal involves not only meeting positive objectives such as receiving attractive interest yields and a relatively liquid asset, but also overcoming such negative aspects as fear of capital loss and distrust of savings instruments.

In the more heavily populated urban areas there are usually banks and other savings institutions that are accessible to savers, but this is less likely to be the case in the rural areas. Because it usually would not be economical for banks to have branches in these sparsely populated areas, other outlets, such as village co-ops, are likely to be a more appropriate vehicle for savings. While saving-by-mail has reached a highly developed state in the United States, this system is not generally practical for most rural areas because so few savers have checking accounts and because of the risk and expense of sending currency by mail. Until safe and accessible outlets for savings can be provided to the rural populace, the bulk of the saving that occurs is likely to be channeled into tangible rather than financial assets, except, of course, cash hoards. One fruitful approach might be to try to make postal savings more attractive. This hinges to a large extent on willingness to pay sufficiently high rates of interest, to increase their convenience, and to reduce red tape.

Savings rates might also be increased by designing the instruments so as to meet more fully savers' objectives. This could involve providing more savings instruments in smaller denominations and with a wide variety of maturities. If the passbook, savings certificate, or other form of savings instrument should be lost or destroyed, it would be helpful to have an arrangement providing for complete restitution of the sum lost. This is one of the attractive features of the United States Series E savings bond. Depending on the situation of the saver, it is often helpful if the savings can be readily converted into cash without any significant loss of funds. In some countries, provision is also made for temporary advances against savings accounts so that earned interest will not be lost.

In some countries, special features have been attached to government savings instruments in order to increase their attractiveness. Government loans with a lottery feature attached but no interest return have been used in the United Kingdom with some success. Indexing of bonds and the denomination of bonds and deposits in foreign currencies have also been used by some countries in an attempt to maintain the purchasing power of the investment. For example, Israel has issued both bonds containing a "dollar clause" which gives protection against devaluation of the currency and bonds with the value linked to a cost of living index. The use of indexing has both advantages and disadvantages, and evidence on the long-term benefit of such a device is inconclusive. Another device used with indifferent success is the provision for either variable or progressive interest rates on debt instruments. More promising is a feature permitting conversion of bonds into common stocks of the same organization, and such convertible bonds are a common feature of various industrialized countries.

In the final analysis, the general economic policies and structure of financial institutions is likely to play a more helpful long-run role in promoting increased savings than any special features attached to savings instruments. But there may be special situations where such devices would be advantageous given the particular social and economic environment of the area.

Economic Policies and Savings

Economic policies, both in the public and private sectors, can have a major influence on the rate of savings. In the public sector, three areas can be distinguished: the maintenance of price stability, the use of interest rate policy, and the employment of various fiscal and tax policies to stimulate savings.

For some years there has been general agreement that inflation has a detrimental effect on the rate of saving.[8] Potential savers, particularly in the wake of postwar inflation have feared a decline in the real value of their money. It consequently follows that if the fiscal and monetary authorities are to provide a climate conducive to an expansion of savings, the maintenance of general price stability is of key importance.

An examination of 18 Latin American republics between 1953 and 1962 indicates that in all of the twelve countries with little or moderate inflation, gains were registered in the proportion of time and savings deposits to total money supply. In the six inflationary countries, however, there were declines in the proportion for three of the countries, no change in one country, and increases in two countries. In one of the latter two countries, however, the inclusion of time deposits denominated in foreign currencies and converted at depreciated exchange rates obscured the significance of the data.

An area for encouraging savings that has been relatively untapped and offers a promising potential is the use of higher interest rates. In two Far Eastern countries during the past decade, a deliberate policy of offering higher interest rates on savings was followed by a substantial expansion in savings. In Thailand in 1956 interest rates on government bonds were raised from an average level of about 4 per cent to 8 per cent. Private sector holdings of government bonds rose from 13.7 million baht at the beginning of 1956 to 33.1 million baht at the end of the year. By the end of 1960 the total was 263

8/ For example, in the early 1950's a U.N. working party concluded "Continued and progressive inflation weakens the confidence in the currency and reduces the willingness to save." Mobilization of Domestic Capital: Report and Documents of the First Working Party of Experts, Bangkok, 1952, p. 6.

million baht. China: Taiwan has had similar success in floating government bonds with very attractive rates of interest. With short-term money rates running as high as 3 per cent a month, the government in 1959 floated 2-year bonds bearing interest at the rate of 14 per cent, tax free. These were easily marketed. The Chinese have also been very successful in using realistic interest rates to attract savings deposits. In 1952, the banks raised interest rates on certain deposits as high as 4.6 per cent a month. This had a remarkable effect in attracting funds to the banks and the gains were held subsequently even though interest rates were greatly reduced.

These examples indicate that higher interest rates can promote a substantial rise in savings in the form of financial assets. Nevertheless, many governments are reluctant to take such a step, mainly because of the higher interest burden that would be involved for government debt. It is not yet sufficiently widely appreciated that the cost of interest to the government is not a valid basis on which to determine the rate of interest that should prevail in a society. It would appear that the use of interest rates to stimulate increased savings has not been exploited sufficiently by many of the fiscal and monetary authorities in the less developed areas.

A third area offering possibilities for expanding the rate of savings consists of various fiscal and tax policies. An E.C.A.F.E. study[9] expresses the view that by restraining current expenditures, many governments can expand capital expenditures and thereby augment the share of saving contributed by the government. In this connection it is also suggested that the separation of the government's budget into current and capital accounts might help promote greater savings.

On a more detailed basis, various tax policies can be used to encourage savings. These would include the use of accelerated depreciation allowances to help business expand their volume of retained earnings, exempting interest income from taxes in whole or in part, and expanding the government-financed infrastructure of the economy to make more profitable business saving and reinvestment. Many governments, including the United States, have exempted interest earned from some government bonds from taxation. The reason for Japan's phenomenally high rate of savings may be due in part to the fact that interest earned on investments of up to $1,400 is legally exempt from taxes, and evasion of taxation on other interest income is widespread.

Although it has sometimes been suggested that the tax system be used to redistribute income in favor of "automatic" (i.e., high-income) savers in order to increase the average rate of saving, such a policy is not likely to be very successful. Not only are the possible changes likely to be relatively modest, but the policy would be counter to the usual social trends in the postwar period.

9/ Annual Report to the Economic and Social Council (March 20, 1962 - March 18 1963), Economic Commission for Asia and the Far East, Bangkok, May 6, 1963, p. 75.

Similarly, the evidence is inconclusive that the achievement of a high per capita income is a guarantee of a high savings rate. Various sources indicate that there is no firm relationship.[10] This means that a policy of increasing a country's per capita income, if successful, will not lead automatically to a higher rate of savings.

There is one question, however, that merits further investigation, viz., "Is the saving potential of the less developed countries larger than has been generally supposed?" For many years it has been argued that the possibilities of increasing savings voluntarily in low income countries is very limited because most of the population exists close to the margin of subsistence and has no surplus to be saved. There is growing recognition that this is not necessarily the case.[11] If the answer to the above question is in the affirmative, this suggests that new policies to promote savings might be successfully introduced to tap this reservoir of funds.

Conclusion

The problem of increasing the rate of saving is basically a long-term problem which is not likely to be solved quickly. An extensive system of sound financial institutions and savings instruments must be established, and a sufficient period of price stability must be achieved in order to obtain public confidence in the various savings media.

There are several areas where both the public and private sectors could be more venturesome in stimulating higher rates of saving. One is in the field of interest rates. There are indications that if savers were offered much more attractive interest rates in the less developed countries, there would be a favorable response. This would also help promote a greater flow of savings into financial assets which in turn should permit a more efficient use of savings resources.

Another area where more could be done is that of inculcating in the people habits of thrift and realization of the benefits of saving. Merely showing how fast savings grow at certain rates of compound interest could be very important in increasing public interest in savings. Relatively little is done in this field in many of the less developed countries, but some countries, such as India, have acted to discourage extravagant expenditures on such things as weddings.

Studies of, or experiment with, more appropriate savings institutions is also a relatively untouched area. Overemphasis has probably been placed on savings institutions for the urban areas, the rural area being relatively neglected in many countries. The same observation could also be made of savings instruments.

10/ Economic Bulletin for Asia and the Far East, op. cit.; and "Private Savings Flows and Economic Growth," Proceedings: Fourth Meeting of Technicians of Central Banks of the American Continent, Washington, D.C., 1955, p. 301.

11/ See Haraldson, Wesley, Foreign Service Journal, June 1963, pp. 51-55; and Shanti Lal Sarupria, "Individual Savings in an Underdeveloped Economy," The Economic Weekly, June 22, 1963, Bombay, pp. 995-1002.

Although relatively few of the underdeveloped countries have experienced a steady uptrend in the rate of savings in the postwar period, it is possible that such actions as those suggested in this paper could inaugurate such a trend. In assessing the probable success of such actions, it would be helpful to have more information on the amount of potential savings that could be tapped by appropriate policies. While an expansion in the rate of savings is important, it should be remembered that an increased flow of savings into financial assets is also important if industrial development is to be promoted along with substantial growth of the total economy.