

Facts vs Theories of Saving in South Africa

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Abstract

Saving in South Africa is about 13% of the Gross Domestic Product, which is far less compared to the global standards. Therefore, this research investigates the theories and facts about saving. The information obtained from the research is used to find out whether saving responds to the theory of saving in South Africa. It will also investigate factors that contribute to dissaving in South Africa.

Introduction highlights the facts as well as theories of saving. The literature review of this paper is focusing on analysis of relationship between saving, investment and growth, especially in developed and developing countries. South Africa being part of developing countries, its economic performance is scrutinized. Evidence has shown that some developing countries' investment is more than domestic saving, whereas in developed countries investment is less than saving. According to Mason, countries like Korea and Sri Lanka have less saving but high investment, reason being more foreign investment is poured to these countries (Population and Development Review, vol. 14, 1988).

South African policies which are aiming at boosting saving are also analyzed. Models of saving and consumption by Modiglian, Brumberg and others are considered. Growth models that emanate from saving are also taken into consideration. The correlation between South African saving and investment is analyzed.

The research also looks at the state of South African economy whether it encourages the citizens to save. The latter will consider propensity to consume and propensity to save, income, income distribution, inflation rate, unemployment rate, interest rate etc

The conclusion summarizes the findings about the facts and theories of saving. Recommendations are made.

Introduction

Why do people save? Browning and Lusardi (1996) highlights motives of saving which most of them emanate from Keynes motives of savings. They have listed the following motives:

1. To build up a reserve against unforeseen contingencies (*the precautionary motive*).
2. To save for retirement (*life cycle motive*).
3. To enjoy interest and appreciation (*the inter-temporal substitution motive*).
4. To enjoy gradual increasing expenditure (*improvement motive*).
5. To enjoy a sense of independence and the power to do things (*independence motive*).
6. To carry out business projects (*the enterprise motive*).
7. To bequeath a fortune (*the bequests motive*).
8. To satisfy pure miserliness (*the avarice motive*).
9. To accumulate deposits to buy houses, cars and other durables (*the downpayment motive*).

Among these motives, there are those motives that are not easy to understand why people opt for them. For example the avarice motive (miserliness); to some extent it does not make any sense to save for no purpose but saving for the sake of being a miser. Considering the above motives to save, it becomes important to emphasize saving. The motive of this paper is also looking at the importance of saving in South Africa. It also looks at the possibilities of saving by South Africans.

Recently the governor of the reserve bank has been emphasizing on saving. He has been stressing that South Africans are not saving, instead the level of credit is escalating. This is true because the CPI has been showing the signs of increasing. The level of buying on credit has also been escalating. This kind of behaviour is not a good sign in the economy of the country. As more people

depend on credit, the country is going to experience debt, and this will lead to outside borrowing which will increase the country's deficit.

It is not only the South African governor who is concerned about the level of saving by South Africans. In the Retail Debt Management conference held in Sun City South Africa, the national treasury chief director of liability management highlighted that the low savings rate in South Africa is a concern. He further stated that only 13% of the gross domestic product (GDP) of South Africa is saved. However the spending by South Africans is increasing at an alarming rate. This has been shown by the Consumer Price Index (CPI) which is at 7 % (stats SA). Household savings in SA is almost non-existent. Only 0.01% of the household's disposable income is saved. South African Chamber of Business (Sacob) further states that high spending in South Africa has exposed the country to a current account deficit crisis which is currently at 7% of the GDP. South Africans have reached a point whereby they are living beyond their means. Almost R90 billion worth of foreign capital investment this year alone is needed to sustain current domestic spending. SARB has counter acted by increasing interest rates; Economists like Downing of the Sacob supported this by stating that an increase in the interest rates is the only way to go.

Facts

South Africa is coming from the legacy of apartheid, where a majority of South Africans were deprived from acquiring basic needs. In 1994 a democratically elected government took over. These elections brought more changes in the lives of most disadvantaged South Africans. Opportunities which they were deprived of began to open up for them. Every South African was free to make choices about his/her life. They could own decent houses, buy luxurious cars on credit, take their children to schools of their choices, could apply for educational loans and other credit loans and can have medical aid insurances,

These opportunities were also enjoyed by rural people. Since 1994 most rural areas have been electrified, access to clean water and the major roads have been tarred. These major changes in infrastructure are giving rural people new responsibilities and these responsibilities come with cost.

Clean water sanitation and electricity

From 1994 the government has made a significant progress in addressing major development changes such as improving people's access to electricity clean water and sanitation. According to Luthango 2003, electricity connection increases from 32% in 1996 to 70% in 2001, and access to clean water during the same period increases from 60% to 85% and sanitation increased from 49% to 63%.

Housing

Pre apartheid era black people were pushed to the margins of the city, which resulted in being distanced from opportunities of the city life. After 1994 democracy was adopted, which led to many changes in social life. Democracy brought changes by means of accessing every one to better opportunities. These changes encouraged the marginalized people to move from the outskirts of the cities into the cities. This resulted in densification of the cities. This migration to the cities increased the cost of living through rent payment and other necessities.

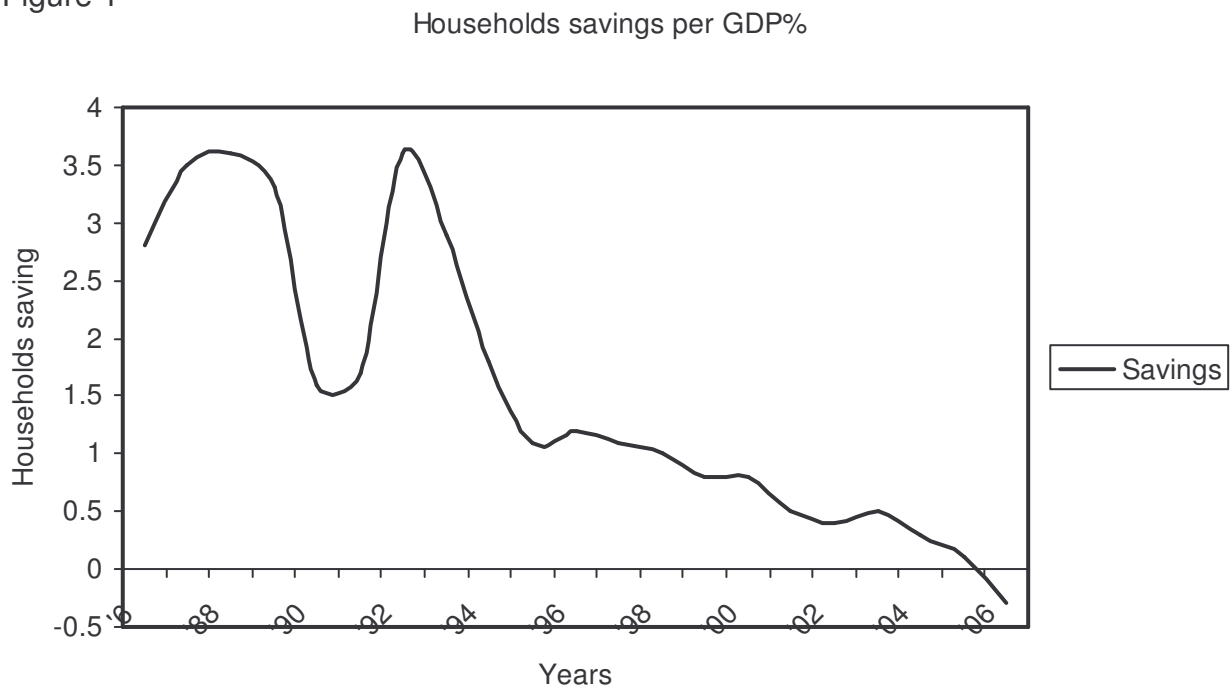
Since 1994 most South Africans has been exposed in the freedom of movement. With the scrapping of the group areas act, South African could relocate wherever they want to be. Most people opted to move towards urban areas where job can be found easily. This migration comes with higher prices especially buying expensive property and paying higher rates, which was not the case when they were living in townships. These higher prices have decreased people's income to an extent that most of the civil servants cannot buy decent housed with their salaries. This escalation of prices has caused the civil servants to take it on the

streets (strike) in May 2007. The strike emanated from dissatisfaction by civil servants where an ordinary teacher's salary cannot allow him to buy a decent house.

Easy access to credit

These changes in lifestyle and access to credit became a problem in managing their income. Easy access to credit was strived by the new government to protect the former marginalized groups allowed them to own durables such as houses cars and furniture. It is known that debt needs to be serviced; therefore interest rates were expected to be paid as the cost of borrowing. Interest rate reduced their disposable income and they were drawn deeper and deeper into credit. This led to the situation which is depicted by the graph below. Households saving has been declining since 1996. The worst case has been experienced in 2006 where household saving has become negative. Saving by the households in 2006 was -0.3% of the GDP (SARB).

Figure 1



Source: SARB

The overall saving by all sectors in South Africa is also not attractive when one considers that a healthy economy is boosted by healthy investments. According to Solow growth model Branson (1989) saving is expected to be more than investment in order to consider growth as possible. This is not the case with South Africa where total saving is only 13% of the GDP. In 2006 gross saving has decrease up to 13.9% of the Gross Domestic Product (GDP). This is shown by the graph below where gross saving pattern has been declining since 1988.

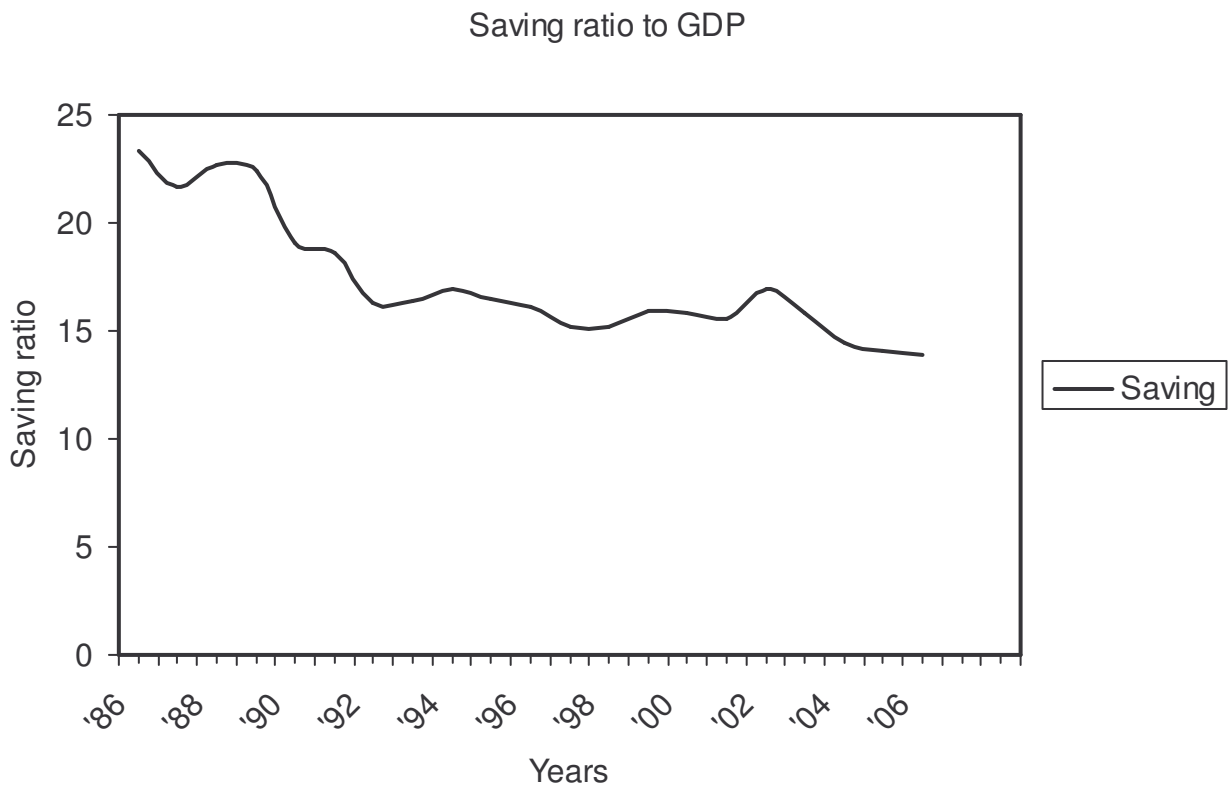


Figure 2

The graph above shows what has been happening in saving since 1984 to 2006. In the late 1980's saving ratio to GDP was above 20%, and after 1980's it was below 18%, and in 2006 it reached 13.9% which makes it impossible to sustain South Africa's investment. Without investment it is impossible to create jobs therefore saving is crucial for increasing investment. This has been proved by the unemployment rate which is standing at 25.5% (Stats SA).

Education

The marginalized societies are experiencing higher standards of living which is backed up by expensive education. The little income these people have, they spend it in education for their children because it is believed that better educated person is in the position of getting better opportunities and better jobs. So their marginal propensity to save is taken up by higher consumption in education. Prior 1994 the level of educated South Africans was lower, because of the opportunities that were deprived from other racial groups. Even-though universities were open to all groups it was at a very low scale. High schools were segregated with unequal standards where white high schools were equipped better compared to other races in terms of subsidies. White high schools were getting 5 times of what was given to other races.

After 1994 parents wanted the best education for their children. Since they were free to move in urban areas, their children had to attend schools in those areas. It was becoming difficult to manage big numbers that emanate from migration of people to cities. The school fees were increase to maintain the standard because the government had to divided subsidies equally for all schools. Parents have to pay more for their children at school. The level of consumption increased tremendously which is the key to dissaving.

It is appreciated that the governor of the reserve bank is concerned about the spending rate of the South Africans, but he should consider the above reasons that compel them to spend because most of their income is spend on necessities.

He should also consider that the unemployment rate is very high, which is the other reason why South Africans are drawn deeper and deeper into debt. After 1994 more than half a million jobs were lost and this led to an increase in unemployment which is standing at 25.5% (Stats SA).

FDI and Investment

There has been evidence that most developing countries lack ability to save. This evidence has been experienced in the Asian countries where high growth has been experienced not through savings. According to Mason Asian tigers achieved high level of growth through foreign direct investment not through domestic saving. This has been a results of seeing investment always exceed savings, where as it is not the same as in United States as well as other developed countries.

Savings being the engine of growth, a country with high rate of saving will have more capital per worker. In the basic neoclassical growth model. In Solow model for example the role of saving rate is important because it is the key to output and output is the key to growth.(Branson p 599)

The situation in South Africa is also following the same pattern as the Asian countries whereby investment is higher than saving but economic growth is not as high as of these countries. In 2006 South Africa has been enjoying the growth rate of above 4% irrespective of the high unemployment rate. There are several factors that have contributed in this. FDI can also be considered as one of those factors but the industry that has contributed the most to growth is service industry. Below is the table showing the level of saving and the level of growth as a result of investment which is higher than saving.

Table 1

Year	'98	'99	'00	'01	'02	'03	'04
Growth rate	0.5	2.4	4.2	2.7	3.7	3.0	4.5
Gross saving rate	15.2	15.87	15.8	15.6	16.8	15.8	14.4

Source Stats SA

It is surprising that growth in South Africa is experienced irrespective of lower saving. In the table above SA growth that has been experienced since 2004 is more than 4%. If one looks at the rate of saving it has been declining since 2000 but the rate of growth has been increasing. In 2000 the growth rate was 4.2 and the rate of saving was 15.8. This can be compared with 1998 where the growth rate was 0.5 and saving was 15.2. The above figures show clearly that South African growth does not depend on the rate of domestic saving but other factors are contributing towards higher rate of growth FDI being one of them.

According to Tseng and Zebregs (2002) in their studies of China and foreign direct investment, they argued that China has benefited from its development policies towards attracting foreign investment. This does not take place only in China, also in countries like Korea and Sri Lanka the pattern shows that their investment is always higher than the rate of saving (Mason 1996). As it has been mentioned above that South Africa is also showing that its saving ratio is lower than its investment but growth rate is increasing. South Africa is also showing the pattern of Sri Lanka and Korea where there is growth irrespective of low levels of saving. The issue is also the foreign direct investment that boosts South African growth.

Theory of savings

In theory savings is part of income which is not consumed. This can be explained by a simple consumption function:

$$C = A + \beta(Y - Y_d) \text{ and saving function is}$$

Where c = autonomous consumption, β = portion of disposable income that is saved, Y = income and Y_d = disposable income.

According to Modigliani, savings depends on labour income W and consumer net worth given by K in the simple growth model

Therefore his consumption function poses as follows:

$$C = \beta_0 W + \beta_1 K$$

Taking the Kaldor saving function where he considers savings ratio as a function of profit rate as well as capital-output ratio. In his model he assumes that wage income (W) plus profit income (P) make output (Q), therefore saving ratio out of profits (s_p) is greater than saving ratio out of wages (s_w): that is $1 > s_p > s_w > 0$ so the overall saving ratio is:

$s = S/Q$ which is derived as follows:

$$W + P = Q \text{ therefore } S = s_w(Q-P) + s_p(P) = s_wQ + (s_p - s_w)P$$

Therefore Kaldor's basic function of saving is

$$S = s_wW + s_pP$$

Where:

W is wage income,

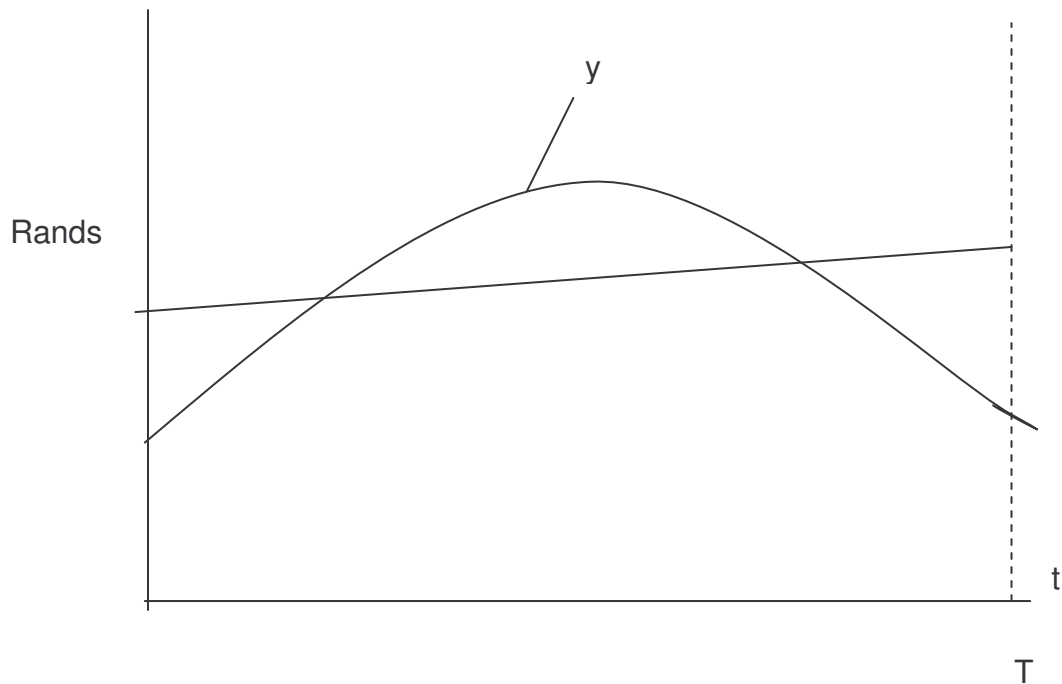
P is profit income,

Q is output,

s_p is the saving ratio out of profit income and

s_w is the saving ratio out of wage income.

Although Ado-Modigliani (A-M) also have their saving function ratio which differs a little bit from that of Kaldor because A-M considers consumption as the key to saving. They look at saving more on the side of the consumption. They consider saving as the key for the future consumption. They are common with Kaldor on one aspect of income. It does not matter whether income is profit or wage. According to them saving at an earlier stage and later stage is less compared to an in between stage.



The above graph is depicting the earlier stage of saving which (Left triangle) which is less compared to point y which is the in between stage of saving and the last stage of saving (retirement stage) which is the right triangle.

Modigliani and Brumberg started a saving theory from a utility function of an individual consumer. This utility function is assumed to a function of the consumers own aggregate consumption in the current and future period. The consumer is assumed to maximize his utility subject to the resources available to him. These resources being the sum of current and discounted future earnings over his life time and his current net worth. According to this theory, a consumer maximizes utility by choosing an optimal consumption level given the preferences and the resources available both now and in the future. The optimal level of savings is then determined by the optimal consumption pattern.

Angus Deaton in his theory of saving examines the behaviour of impatient consumer who prefers consumption now to consumption later. This consumers are unpersuaded by the result of waiting. He maintains that the income of these consumers are uncertain and this uncertainty is a factor that comes from being

impatient. This uncertainty by these consumers require liquidity. Jappeli and Pagano concur the liquidity by stating that liquidity constraint explains the excessive sensitivity of consumption to anticipated income fluctuation. They maintained that less attention has been devoted to the effect of liquidity constraint on aggregate savings rate. It has been observed that South Africans are impatient consumers who want to consume now, but consumption now requires liquidity. The later confirms that South Africans are dissaving because they prefer to consume now.

CONCLUSION

Income of The South Africans are consumed in various ways. The legacy of apartheid deprived most of people opportunities of having basic needs. It is only now that South Africans are starting to accumulate their wealth by buying durables. It is a trend that their income is spent on their immediate families as well as their extended families in developing countries; therefore the government should address the issue of imbalances in income distribution.

The Reserve bank strategy of increasing interest rate to encourage saving and discourage consumption usually will not materialized if people do not have a potential to save. South Africa with more than 50% of the population living under poverty line, cannot absorb expected saving from its households. It has shown that in 2006 the saving ratio was negative. The government of South Africa should follow china strategy of development of acquiring as more foreign Direct Investment (FDI). Productivity should be increase to attract FDI. This will compel South African government to address the Cosatu and other unions problems immediately in order to attract more foreign investment.

Since it has been witnessed that property and food prices are increasing, the government should interfere in the pricing of the necessities like food and housing.

The government should decentralize by providing rural areas with the necessary infrastructure and encourage to encourage investment in these. This can be done by encouraging people to settle in their areas and be provided with jobs. In order for the government to control building priced, it should nationalize building material

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