

## *Nedbank and Old-Mutual Budget Speech Competition*

*South Africa's savings rate is currently 13,8% of GDP – low by international standards. Despite initiatives like the Mzansi bank account which aims to take banking services to the previously “unbanked” and the introduction of the retail bond, the rate is not improving. What can be done to improve our savings rate? (Words: 2499).*

# **The “Piggybank” Principle:**

## **Problems and Possible Solutions to South Africa's Savings Crisis**

### **1. Introduction**

South Africans' piggybanks are either slim or starving, due to South Africa's low current savings rate of 13,8% of GDP (SARB, 2007: 10). The dismal state of private savings is accentuated by figures from the South African Reserve Bank *Quarterly Bulletin*, which indicate negative household saving levels of -0,7% in the last quarter of 2006 (Fin24, 2007). As a relatively small country with an Apartheid legacy, South Africa faces many problems which have detrimental effects on the saving rate, such as poverty, unemployment, low skills levels, high levels of HIV/AIDS, a detached second economy and the shortage of personal property ownership. While recent government initiatives, such as JIPSA and the promotion of micro finance organisations, have managed to address some of the constraints, evidence from other developing countries suggests that more can be done in the fields of education and credit legislation. This paper attempts to identify obstacles to saving in South Africa, and discusses possible solutions to this problem.

### **2. The Theory behind the Thinking**

South Africa is growing at an optimistic 5%, and the hope of increased future incomes raises the question as to why savings should be considered so important (SARB, 2007:1). The answer is twofold. Firstly, although an increase in the savings rate cannot lead to sustained per capita income growth, it can lead to a higher level of per capita income in the long-run (Blanchard, 2006:231). Secondly, South Africa's excessive dependence on foreign capital inflows to finance its record current account deficit, 7, 8% of GDP in the fourth quarter of

2006, leaves it vulnerable to external shocks and changes in investor sentiments towards developing countries (SARB, 2007: 11; Van der Merwe, 2007). An increase in the savings rate can help improve the ratio of domestic to foreign capital, thereby reducing the scope of the negative impact that capital flight can have on our growth momentum. The government should attempt to improve the terms-of-trade, because studies of 41 sub-Saharan countries indicate that *external debt reduction* greatly increases national savings, possibly due to reduced future tax expectations (Agénor, 2004: 52). When compared to other fast growing developing countries, such as China, which has a growth rate of 10% and a saving rate of 50%, it is clear that South Africa can improve its performance significantly (Fin24, 2007).

According to the classical view of economics, a higher interest rate will decrease the debt level and stimulate savings, because the opportunity cost of consumption becomes higher and the reward for saving becomes greater (Arnold, 2004: 210). Unfortunately, a realistic solution to South Africa's debt crisis will not come so easily, as credit growth remained unaffected by repo rate increases of 200 basis points between June and December of 2006 (Bell, 2007). This is consistent with a study by Ogaki, Ostry and Reinhart, which indicates that the effect of interest rate changes on savings is weak in developing countries (Agénor & Montiel, 1999: 95).

The Keynesian view, which asserts that individuals save for many different reasons not linked to any single factor, appears to be more applicable to the South African context (Arnold, 2004: 230). Keynes believed that savings are more responsive to changes in income than to the interest rate. If changes in disposable income are the main determinant of savings, South Africa's lack of savings can be traced back to poverty and unemployment.

### **3. The Wolves that can Burn Down the Bank**

It is self-evident that individuals who have no income cannot save. Unfortunately, a study by The National Labour and Economic Development Institute affirmed that levels of poverty and unemployment remain "critically high", despite South Africa's reputation as an upper middle class country (Frye, 2006). It was estimated that 48, 5% of people were living under the national poverty line of R354 per month in 2002, while 41% of people of working age were unemployed according to the broad definition (Frye, 2006). The fact that poverty and unemployment are structural rather than cyclical in nature makes it complicated to tackle

these problems through policy intervention (Frye, 2006). The following section will examine various obstacles to the improvement of South Africa's mediocre savings rate.

The shortage of skilled labour contributes significantly to South Africa's high unemployment rate, with 80% of firms indicating that managerial and professional staff is moderately or extremely hard to find (Lewis, 2002: 7). Amongst unskilled and semi-skilled workers, current income plays a major role in determining consumption, because liquidity constraints prevent households from transferring resources across time periods (Agénor, 2004: 41). These households, which represent the vast majority in South Africa, typically engage only in *buffer-stock* savings, which means that only a small amount is saved for emergencies (Romer, 2006: 371). The result is that a small fraction of individuals, who can accumulate capital and resources to save and invest, hold the vast majority of wealth.

The unemployment level is further worsened by the "brain drain" South Africa is experiencing, with an estimate that 20% of skilled workers have left the country since 1994 (Ingham, 2004: 127). The effect of this exodus on the population is intensified by the fact that as many as ten unskilled jobs might be lost for every skilled worker that leaves.

HIV/AIDS infection also poses a significant threat to future savings in South Africa, because its prevalence is the highest among the productive section of the population; estimated to be 16,2% among people between 25 and 49 years old in 2005 (Noble, 2005). Shockingly, 71% of deaths in this age group are caused by AIDS, often leaving children and the elderly without any source of income, while undermining the transmission of human capital across generations (Bell et al., 2006: 55). Research in 64 developing countries indicated that this increase in the *age dependency ratio* decreases public savings substantially (Agénor, 2004: 38). The *propensity to save* is highest in middle age, when earnings tend to be relatively high, which means that death amongst workers in the productive age-group will have a considerable negative effect on the overall savings level (Agénor, 2004: 597). Vigorous government action is desperately needed in the provision of free antiretrovirals and accurate education on HIV/AIDS prevention.

Without government assistance, citizens who form part of the second economy have little hope of saving, because most of them struggle to survive and have little financial surety (Finscope, 2006: 1). Without ownership of property, many unemployed workers do not have a

positive net worth against which they can borrow and therefore cannot accumulate capital. Excluded from the formal economy, they remain unable to engage in entrepreneurial activities, because they do not have funds to cover their input costs with (Simanowitz, 2007). Amongst those who manage to borrow, 18% say that the primary reason for debt has its origin in basic necessity such as food purchases, while 10% and 9% cite funeral money and school fees respectively (Finscope, 2006). This form of dissaving decreases the chance of future savings, because these debts are not used for profit generation and have to be repaid with interest.

## **4. Better Skills and Shared Piggybanks**

To improve the savings rate, South Africa needs sound credit legislation, the inclusive provision of access to financial institutions like banking facilities and, most importantly, widespread financial education. It is necessary to address the negative legacies of our past by actively helping to reduce extreme income inequality and by providing education to the people who did not have the opportunity to empower themselves. The following sections will consider possible initiatives which could lead to the improvement of our savings rate.

The government has already begun to implement initiatives aimed at addressing the underlying causes of our savings crisis. The Joint Initiative for Priority Skills Acquisition (JIPSA) was launched in an attempt to address the problems of unemployment and the shortage of skilled labour (Mlambo-Ngcuka, 2006). Special training programmes, the re-employment of retirees and the recruitment of Africans who work out of Africa can all help to improve South Africa's skills level. Adult Basic and Education Training programmes will also contribute to the empowerment of the most impoverished citizens (Mlambo-Ngcuka, 2006). It is advisable that the government should consider relaxing the restrictive criteria of Affirmative Action until there are enough suitable candidates to fill highly skilled positions. When professionals leave the country because they cannot find jobs, essential skills are lost, which is disadvantageous to all South Africans.

After much criticism against the elite enrichment created by Black Economic Empowerment (BEE), the government has implemented Broad Based BEE in a renewed effort to support shared growth (Mlambo-Ngcuka, 2006). This project is complemented by the National African Chamber of Commerce's commitment to establish 100 000 new small and medium enterprises every year, which should create much needed jobs. The R5 billion committed to

small business loans in the Financial Service Charter will enable more people to enter the formal economy (Mlambo-Ngcuka, 2006). Hopefully, these initiatives will help to create a black middle class that can play a significant role in improving South Africa's savings rate. Studies in developing countries show that savings increase with per capita income, particularly when the transition from low to middle-income levels occurs (Agénor, 2004: 52).

New Institutional Economics emphasises the role that good institutions play, through their encouragement of investment in human capital, in the creation of economic prosperity (Acemoglu, 2003: 27). Since more than 13 million of the 27 million adults in South Africa do not even have basic transaction facilities, changes can be made which will promote savings and opportunities. However, the government cannot simply impose a formal financial market model on our second economy; but have to "create new institutions that are capable of meeting the urgent challenges of development" (ANC Economic Transformation Committee, 2005). It is necessary to work with the "existing strengths and assets of communities" in the informal economy (ANC Economic Transformation Committee, 2005). Micro-finance organisations (MFO) do this by increasing the access of poor people to saving and credit facilities, thereby enabling them to purchase physical capital inputs and "increase the productivity of existing assets" (ANC Economic Transformation Committee, 2005).

The Small Enterprise Foundation (SEF) sets a good example by promoting the "culture of savings" needed for long-term security and success. By attaching compulsory minimum savings, from as little as R2,50 per week, to small business loans of R300 or more, SEF "breaks the cycle of vulnerability" by enabling business development which secure a reliable source of basic income to individuals and their families (Simanowitz, 2006). As an indication of its effectiveness, the 6000 active SEF-members currently have a savings balance of R1, 25 million in group accounts and extensive personal savings. SEF never takes collateral, but uses *peer pressure* and *group guarantees* to ensure repayment. With a default rate of close to zero, SEF demonstrates that microfinance institutions, with alternative and viable solutions to South Africa's savings crisis, can be hugely successful.

The Savings and Credit Cooperative (SACCO) also builds on the tradition of popular organisation, prevalent in burial societies, and offer a collective approach to improve the savings rate through education that focuses on self-help principles. The Banking Sector Education and Training Authority (SETA) should enhance its role in capacity building to complement the efforts of MFOs. The state could participate by subsidising savings and

transaction services for the poorest citizens; an initiative that will help establish financial institutions that cannot emerge otherwise (ANC Economic Transformation Committee, 2005). The development of financial markets will have a positive effect on the productivity of capital, and the corresponding higher income generation can lead to an improved savings rate (Agénor & Montiel, 1999: 688-9).

## **5. Stopping the Shopping Culture through Financial Education**

Although many South Africans earn substantial incomes, a study by Research Surveys reveals that allegedly only 7% manage to save (Finscope, 2006). Higher disposable incomes often increase “consumer spending and credit demand for luxury imported items”, because people jump on the *status spending* bandwagon, instead of investing in assets that will appreciate in value (Mail&Guardian, 2007). This tendency is apparent in the ever growing ratio of debt to personal disposable income, which approached a record high of 73, 8% in the fourth quarter of 2006 (SARB, 2007: 11). The debt cycle is clearly evident, with 12% of white higher income earners admitting that they will take out a loan in order to pay off another debt (Finscope, 2006). As interest rates households pay on credit cards and other borrowing usually far exceed rates earned on savings; every debt decreases an individual’s future ability to save (Romer, 2006: 375).

Serious action is needed to decrease credit spending in South Africa. Both the government’s new mandatory social security scheme, which functions like a form of compulsory saving, and the abolishment of tax on interest earned from retirement funds should stimulate improvements in the savings rate (SARB, 2007: 3; Fisher-French, 2007). These initiatives are complimented by government credit legislation, such as higher mandatory cash requirements for commercial banks and the restriction of “aggressive marketing of credit to sometimes cash-strapped clients”, which limit the scope for imprudent consumer spending (Bell, 2007). The Policy Framework for Consumer Credit Law and the Consumer Credit Bill which parliament is currently considering will aim to further “tighten regulation of the commercial micro-lending sector [in order] to prevent over-indebtedness” (ANC Economic Transformation Committee, 2005).

While all these initiatives are promising, the central problem remains the lack of financial management knowledge that is clearly prevalent amongst all South Africans. Education on basic money management and the cost of credit needs to be implemented at all levels of society, beginning as curriculum requirements in secondary schools and tertiary institutions (Hurwitz and Luiz, 2007: 130-1). South Africa should learn from countries like Singapore, which has experienced great success with their “Thinking School, Learning Nation” vision, because the strong *intergenerational links* found in developing countries imply that parents also benefit from their children’s financial literacy (Tan, 2006: 90; Agénor, 2004: 41). Government and civil society organizations should contribute by funding financial fitness programs accessible to the entire population. It is essential that citizens realize that savings are a means to provide for future consumption, because saved resources will remain available tomorrow (Blanchard, 2006: 59; Romer, 2006: 348).

## **6. Conclusion**

South Africa has to overcome serious obstacles in order to improve its savings rate. Job creation and skills improvement remain essential in the combat of poverty and unemployment, while broad-based BEE and micro-finance organisations can help to incorporate the second economy into the formal economy. HIV/AIDS education and antiretroviral provision should be high on the government’s agenda, because this disease is extremely costly and targets the most productive sector of the population. Stricter credit legislation will decrease South Africans’ debt burdens, but financial management education is desperately needed at all levels of society. Only when these problems are addressed and initiatives implemented will all South Africans be able to feed their piggybanks regularly and keep them balanced and healthy, while simultaneously improving South Africa’s savings rate.

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