

RAISING THE TIDE

Elevating the South African domestic savings rate

(2 418 words)

Introduction

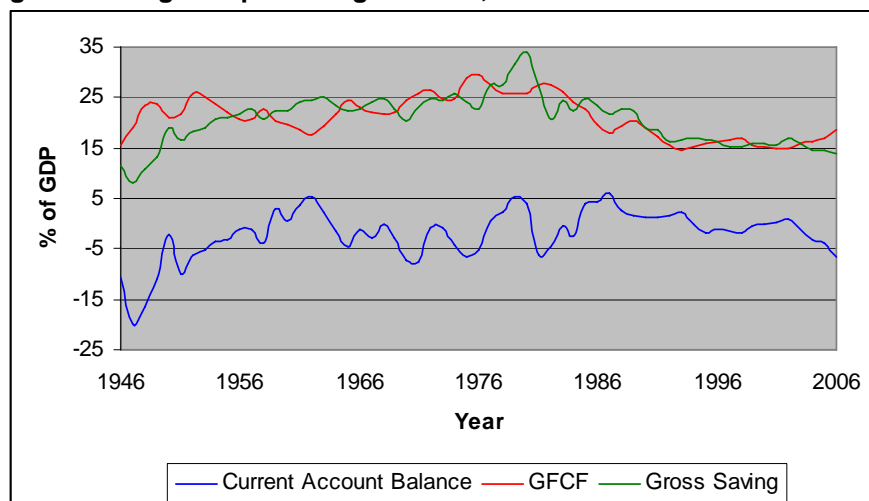
“A rising tide lifts all boats”

John F. Kennedy

Capital formation represents a key component behind rapid and sustained economic growth, and is financed primarily by savings, from both domestic and foreign sources. South Africa has, since 1994, done well in accumulating capital. Fixed investment growth has been positive for the most part, but savings have been decreasing over the same period, meaning that capital formation in South Africa is being increasingly driven by foreign capital inflows, making the country vulnerable to external shocks and exerting pressure on the current account.

Increased savings are important in financing investment projects which increase output, reduce unemployment, ease supply shortages and provide goods for exporting. Savings also lessen the dependence on foreign borrowing, and provide for investment when foreign capital inflows are insufficient.

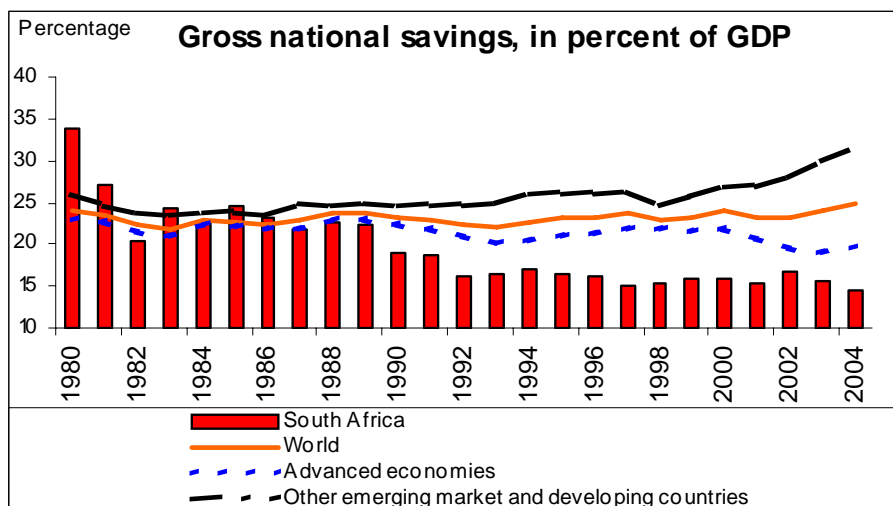
Figure 1: Current account balance, gross fixed capital formation and gross saving as a percentage of GDP, 1946 – 2006



Source: SARB

The South African savings rate (defined as gross savings as a percentage of GDP) is at its lowest level since 1949, indicated by Figure 1. This raises concerns in a country such as South Africa, which hopes to accelerate its growth rate to six percent by 2010 in accordance with the objectives of the Accelerated and Shared Growth Initiative for South Africa (ASGISA) (The Presidency, 2006:3). Whereas, the Growth, Employment and Redistribution (GEAR) programme prescribed an aggregate savings rate of at least 20 percent to support an annual growth rate of four percent (Bisseker & Paton, 2005:19), IMF projections forecast gross national savings of 16 percent of GDP over the next five years – insufficient to support real GDP growth rates of six percent (Economist Intelligence Unit, 2006:29).

Figure 2: Gross national savings as a percentage of GDP, 1980 – 2004



Reproduced from Masilela (2005)

The strong growth experienced by Asian economies was attributed to high capital and labour productivity, as well as a large savings figure. Relative to their standards – and those of the rest of the world (Figure 2) – the South African savings rate is very low. If South Africa is to emulate the Asian growth experience and achieve the growth it so desires, it too needs to raise its savings level.

Why are we not saving?

The weak savings culture in South Africa is attributed to, *inter alia*, the lack of access to financial institutions and financial products for the poor, low productivity and income among the poor, high levels of credit extension, and rampant consumerism

caused by people trying to sustain a very high standard of living, with little or no income left for saving.

If the country successfully overcomes these challenges, South Africa can look forward to an increase in domestic investment, business development, employment and cautious borrowing, all of which are in line with ASGISA objectives.

In light of these problems, innovative ways of promoting savings need to be found.

Getting the house in order

“One should never spend money on anything foolish, like pear nectar or a solid-gold hat“

Woody Allen

In the system of national accounts, household savings is measured as a residual after actual final consumption of households is subtracted from adjusted disposable income (SARB, 2006:S137). However, the definition of final consumption expenditure by households excludes financial services (SARB, 2006:S118). Therefore, savings can be assumed to include bank deposits, ordinary share investments, investments in unit trusts and government securities, and insurance contributions and premiums.

Household savings have fallen to negative levels for the first time¹, caused mainly by widespread credit extension and excessive spending. Without savings, households become financially vulnerable to, for example, job losses and death of income earners.

Improving household savings should start with debt servicing. It is important that households reduce or settle credit card debt, store credit accounts and overdrafts, as these are typically used to finance excess household consumption. Such products have high interest rates, the payment of which adds to household expenses.

¹ South African Reserve Bank data for “savings by households” is only available from 1953 onwards.

At the same time, people with home loans need to increase their mortgage repayments, which significantly reduce interest payments over the loan term. Finally, households will need to cut back on excessive and unnecessary consumption.

Never too young

Poor private savings limits future possibilities for individuals. Currently, only five percent of retiring South Africans have enough savings to support themselves for the rest of their lives (Robbins, 2007).

Savings should be encouraged from a young age, in order for youths to understand the virtues of savings and investment, and to ensure a robust savings culture in the future. Firstly, financial literacy must be included in the national curriculum, where as part of the syllabus, learners will have to save a minimum amount per week, low enough for poor learners to afford, yet high enough to ensure sufficient savings. The learners will eventually be required to open a bank account to manage the money that they have saved.

As the learners progress through school, debt management and long-term financial planning for education, housing and retirement needs to be taught.

Government and financial institutions will need to embark on large scale marketing and education programmes for adults. This may take the form of seminars and workshops that emphasise the importance of savings and try to divert savings held in alternative assets (such as livestock and jewellery) to bank accounts.

Getting the poor to save

“The ultimate luxury is the ability to save”

Johannes van der Horst, former Old Mutual Chief Investments Director

Research has shown that despite their financial situations, the poor can and do save. In the South African case, FinScope found that the propensity to save of people in LSMs 1 to 5 reaches 44 percent, after funeral insurance contributions are taken into account (FinMark Trust, 2007:5). Furthermore, it was discovered that 51

percent of such individuals do not have access to any formal or informal savings products at all (*Ibid.*:6).

Savings are an important tool in improving the livelihoods of the poor. They provide access to their own financial support, collateral security for loans, and funds in times of unemployment.

Stokvels (informal cooperative savings institutions) provide an informal savings and credit vehicle in generally poorer communities. It is an effective tool in developing savings habits as members exert “social pressure” on fellow members to pay their monthly contributions. According to the National Stokvels Association of South Africa, around 8.2 million adults participate in stokvels. Assuming a monthly member contribution of R50, and that no stokvel funds are deposited in banks, stokvel contributions understate recorded savings by some R4.92 billion. Banks should make deposit facilities available to ensure security to the stokvel members, allowing the bank to use the liquidity to provide credit for development projects.

Increased participation in stokvels will encourage the poor to build savings for themselves. However, Deumert and Mabandla (2006:12) identify the lack of permanent employment as a deterrent to stokvel participation, as a regular stream of income is not guaranteed, harming the ability of the member to pay the monthly contribution.

Variants of the stokvel concept which may be applied to South Africa include Christmas clubs, a concept used in the United States which involved regular deposits that were not available for withdrawal until the end of the year.

Government measures

Government has significantly reduced its dissaving of the 1990s, and is expecting its first budget surplus of 0.3% of GDP in the 2006/2007 fiscal year, increasing to 0.6% of GDP in the next year, indicating government’s contribution to a national savings effort. It is important for the government to spend within its means, or to keep a

budget deficit low so that it does not offset savings made by households and the corporate sector.

One of the objectives of recent tax reforms in South Africa is to promote savings. The 2007/2008 National Budget unveiled a number of initiatives, such as the abolition of taxes on retirement funds (National Treasury, 2007a:61-62). Furthermore, exemptions on interest income have increased to R18 000, from R16500 in 2005, and the capital gains exclusion from R12 500 to R15 000 (*Ibid.*:72)

In addition, moderate income tax relief was granted to individuals, thereby increasing their disposable income. In his 2007 Budget Speech, Finance Minister Trevor Manuel encouraged people to use the tax relief to settle their debts or save their money (National Treasury, 2007b:23).

One proposal to encourage portfolio investment is to abolish Capital Gains Tax (CGT). This view is strongly supported by Alan Greenspan, who believes that CGT “impedes entrepreneurial activity and capital formation” (Kolber, 2000), and is a poor tool to generate tax revenue, and may result in double taxation. A complete macroeconomic simulation of a tax cut found an increase in national savings, and small decreases in government revenue (Economist, 1997). Although eradication of CGT is likely to increase income inequality in South Africa, the possible increases in investment and entrepreneurship should result in increases in income tax revenue that can be spent on poverty eradication measures. Since personal income taxes are shown to be ineffective in redistributing income (Bird & Zolt, 2005:5), correcting redistributive issues should be done through government expenditure instead of taxation.

An increase in consumption taxes may reduce the extensive consumerism that exists in the South African economy, but policymakers will need to be wary of how this should be designed, as an increase in a general consumption tax will negatively affect the poor.

Mandatory deposits, proposed by government as part of a social security reform, are advantageous in that they instill discipline by forcing people to save, and they

facilitate access to loans since contributions can serve as collateral. However, compulsory contributions may inhibit future mobilisation of voluntary savings. Kerr (1997:4) reports that in Australia, where a compulsory superannuation scheme was implemented in the early 1990s, contributions merely represented a switch from one form of saving (e.g. repayment of mortgages) to another, thereby causing no change to total savings.

Finally, tax incentives may be considered for people who are able to prove their savings efforts.

On the expenditure side of government, many proposals that indirectly influence savings can be considered. For example, government rollout of antiretroviral treatment may have a positive effect on household savings, as HIV/AIDS infected individuals will be able to carry on working, thereby providing an income for their families, a portion of which may be saved.

The government bond

Government bonds are an excellent vehicle to promote savings and long term planning, while at the same time providing funds for infrastructure development. Provided that government is able to pay its dues to the respective investors, government bonds are a good method of instilling trust in the government.

However, the launch of the government retail bond has not been effective in increasing the savings rate. This may be a problem of marketing, where government has failed to adequately promote the product to individuals. Government may also consider increasing interest rates on government bonds to make them more competitive and increase the demand for them.

Stamping out poverty

As companies, financial institutions such as banks aim to make profits. Testing and implementing new products for the poor are expensive and time consuming. Deposits made by the poor are thus unlikely to make up for the costs involved in developing innovative savings products.

However, Postbank, the deposit taking arm of the South African Post Office (SAPO), has been restructured by government to focus on banking the “unbanked” (SAPO, 2007). Because post offices are accessible to broad customer bases, Postbank has the unique opportunity to capture savings in those areas. With government backing, Postbank has the resources to conduct market research within poorer communities to develop customer profiles, which will aid in the development of adequate savings products, offered at the right price. If Postbank implements diverse savings account offerings, customer service will need to be enhanced. Post offices will need to find ways to reduce turnaround times and ensure that adequate cash is available to meet demand. Also, Postbank will need to ensure the safety of deposits on site.

Waiting for a sign

Increasing savings among wealthy individuals may be as simple as waiting for the boom experienced in the Johannesburg Securities Exchange to end. Fair (2004) observed, using U.S. macroeconomic equations and data, that in the absence of a stock market boom, personal savings rates would be higher than during such a boom. He explained that the wealth created by a boom causes an increase in consumption, and that households consume less with no boom. The growth in consumption caused by individuals cashing in their investments is welcome, as it would contribute to growth.

Banking on tomorrow

Banks will need to increase interest rates on savings deposits to match inflation, keeping the value of the deposits stable. This provides an incentive to save, and is a way of extracting excess liquidity. This will, however, reduce the net interest margin earned by banks, negatively affecting their bottom line. Reduced bank charges will also affect non-interest income of banks, placing further downward pressure on profits and making banks more reluctant to adopt the proposals.

The implementation of the National Credit Act in June 2007 and the Basel II Capital Accord in January 2008 will force banks to improve their risk management systems and become more responsible lenders. This will do well to limit excessive consumer

credit granting, better financial assistance measures in the setting up of companies, and strengthening bank capital adequacy.

Dangling carrots

First National Bank's Million-a-Month Account (MAMA) offers 114 monthly cash prizes ranging from R1 000 to R1 million. With few service fees and the option to earn interest on their deposits (First National Bank, 2007), the account introduced an incentive for people to save. According to Michael Jordaan, CEO of First National Bank, the MAMA attracted 750 000 new accounts (Whitfield, 2007). It is therefore evident that the product appeals to South African consumers. However, the product allegedly contravenes the National Lotteries Act and may be removed, pending a decision from the Supreme Court of Appeal.

If similar models of tying "benefits" to products are applied to the offerings of microfinance institutions, bond issuers and other financial institutions, a similar response is likely, especially from the poor.

Conclusion

Savings is of great benefit to a developing country such as South Africa for a number of reasons. They provide the means for capital accumulation to grow the economy, to build infrastructure, to improve living standards and to develop businesses. The task is therefore to raise the tide to enable these boats to be set in motion.

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