Savings: The way forward

Abstract

The purpose of this essay is to offer suggestions on how to improve the savings situation in South Africa as the savings rate in the country is low by international standards. Firstly we take a detailed look at why consumers do not save in South Africa, so that we can formulate suggestions on how to increase the level of savings. Proposals from a tax perspective are looked at, forced saving is critiqued and China's economic model is briefly studied. Proposals from a tax perspective may be effective, forced saving may be successful provided that the concerns are addressed and the eradication of social assistance may improve the level of savings in the long run once redistribution decreases the level of poverty the country currently has.

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1. Introduction

Yes, the savings rate in South Africa leaves much to be desired, however, we should not dwell on that as a country, we need to find a way forward by finding initiatives to improve the level of savings. In order to find initiatives to improve the savings rate in South Africa, we first need to define savings and the types of savers there are in the economy, then take a detailed look at why consumers do not save in South Africa and offer suggestions to encourage saving. Proposals from a tax perspective are taken to create a more savings friendly tax environment by abolishing tax on workers' retirement funds, exempting tax on interest income and abolishing Secondary Gains Tax (STC). A look is taken at a new initiative by government which forces individuals to save for retirement, disability and death. Concerns arise from the proposed forced savings initiative and an attempt is made to address them. A lesson is learnt from China, which does not provide their population with social security, and a look is taken at the practicality of implementing this in South Africa.

2. Definition of Saving

Saving is the result of a decision not to consume or to defer consumption. Based on theory there are basically four reasons why consumers will save, namely to smooth or maintain a more stable consumption, to provide resources for retirement and bequests, to finance expected and large lifetime expenditure (including residential buildings and education) and to finance unexpected losses of income. According to French (2005:1), "South Africa has one of the lowest savings rates in the world" when you weigh it against other economies worldwide. This is why national savings has emerged as a major theme in the Finance Minister's 2007/2008 Budget Speech. There are basically three types of savers namely individuals, companies and government, of which the "only category that is providing savings of substance is companies" (Cobbett 2007:1). Individuals and government, despite having recently become a net saver after two decades of budget deficits, contribute a small portion to the total savings amount.

3. Reasons Why Consumers Are Not Saving

According to Warwick (2005:21) one of the reasons why consumers do not save is the "lack of confidence in the financial services industry." The foundation on which consumers base their lack of confidence in the financial services industry is that they believe the products in the financial services industry are too complicated and the returns have been declining. However Warwick suggests that another reason why consumers are not saving is that their level of debt is increasing. Consumers also lack the incentive to save for retirement as government social security benefits provide protection for those unwilling to save. Poverty and HIV/AIDS are also reasons why consumers do not save. As most of the population is living in severe poverty it is difficult for consumers to save as they hardly have any money to sustain themselves. Also HIV/AIDS has not only become a health issue, it is a development issue as well as it affects the economy namely through skills availability, savings, demand patterns and productivity. Those who are infected do not save because they have no motivation to save as they will soon die therefore why save.

a) Complicated Financial Services Industry and Declining Returns

It is far simpler for an individual to put their R100 in their cupboard, under their bed or in a hole, where they know that their money will not be eroded by bank charges and it will be easily available. Froyen (2002:448) argues that supply-side economists believe the after-tax return for saving has a significant effect on the saving rate. The rate of return is the after-tax real interest rate, which is the nominal interest rate, minus the expected inflation rate. This implies that the higher the inflation rate, the lower the after-tax return for savings. An increase in inflation causes savings to decrease as inflation erodes savings. Inflation has an unfavorable effect on savings, decreasing the long-run level of investment and it curbs long-term growth. The interest rates for savings accounts are relatively low compared to the interest rates individuals are charged for borrowing. The rationale behind this is to curb borrowing and to maxise profits however this also discourages savings as the return on savings is low. By simplifying the financial sector, and making it promote saving by rewarding consumers for saving by increasing interest earned on savings, this may improve the savings rate. Another reason why the financial services sector is complicated is that some saving products require a notice period before withdrawing funds, therefore money is not easily available.

b) Increasing Level of Debt

In order to save, one needs to decrease the level of debt that consumers have. This implies that debt reduction is a priority if the South African savings rate is to be improved. Before South Africa became a democracy a large proportion of the population was previously excluded in terms of access to credit, housing finance, job opportunities, now Moleketi (2006:2) believes that the decrease in the savings rate may be a result of having gained access credit and more job opportunities. As consumers have gained access to credit and as credit is easily available to consumers, this has increased their level of debt. This increased access to borrowing has decreased saving for future purchases of durable goods. Despite increases in interest rates, consumers in South Africa are still spending and unfortunately they are funding their spending through credit cards, overdrafts and loans or in other words, with money they do not have. By decreasing the availability of credit that is by allowing an individual to only have one credit card and only allowing credit purchases for basic needs such as food and petrol, we may be able to decrease the level of debt in the country and thus improve savings.

c) Government Social Security Benefits

Froyen (2002:473) states that consumers in the United States of America (USA) do not save as "increased social security benefits have reduced the need to save for retirement years." This is the same for South Africa, the budget has steadily been increasing the amount of social grants for pensions through the years as government provides a sense of security for those who do not save for their pensions, there is no incentive for consumers to save for retirement because even if individuals do not save, they will be sustained by the pension grant. Unfortunately, as the pension grant has redistributive aspects, we cannot

call for is abolishment. Ideas to increase savings would be to rather create an incentive for individuals to not rely on pension grants by increasing pensions by an inflationary amount. This would imply that pensioners would receive the real value of money throughout the years and only an increase in the monetary value, thus their purchasing power would remain the same.

4. Proposals from a Tax Perspective

Absa (2007:1) maintains that in general the tax system is not savings friendly and thus recommends the following incentives to encourage savings:

- Abolition of tax on workers' retirement funds;
- Tax exemption of interest income received by individuals; and
- Abolition of Secondary Tax on Companies (STC)

a) Abolition of tax on workers' retirement funds

This was proposed in the Finance Minister's 2007/2008 Budget Speech. This provides the elderly with relatively greater social benefits as it will allow the beneficiaries to obtain better returns on their pensions and encourage them to save more. Bailliu and Reisen (1997:27) suggest that tax exemptions on pension returns should be limited to people who have a low level of savings. This is based on the fact that high savers already provide a bulk of the net savings, therefore the savings rate is then lowered by those individuals who do not save. By providing an environment which is friendly for low savers to save, that is by exempting the low savers from tax on retirement savings, the savings rate will increase. This solution is indeed not just economically viable, but it is equitable as well.

b) Tax exemption of interest income

By taxing interest income, this implies a greater cost of investing and saving therefore consumers will probably opt not to save. By exempting tax on interest income, more consumers will save as they will receive higher returns from their savings and thus increase the savings rate.

c) Abolition of STC

Based on the Budget Speech the Finance Minister announced that STC would be phased out completely by 2008 and will be replaced with a dividend tax at shareholder level. This will bring South Africa in line with the international norms and thus will promote foreign investment. Companies will save more if they do not have to pay STC and this will thus increase the savings rate.

5. New Initiatives: Forced Savings

Fisher-French (2007:1) states that "employed South Africans will pay a percentage of their monthly earnings into a new mandatory social security scheme." This is an attempt by government to create a savings culture. The scheme will not only provide for pension, but also for death and disability. Mandatory public savings can

considerably increase the level of savings in a country and implementing this in South Africa would definitely improve the savings rate, however, there are areas of concern regarding this initiative

a) Areas of concern- Loss of state support

Fisher-French (2007:1) raises a few concerns with regards to forced savings, namely the loss of state support and the issue of workers who leave jobs and cash in on their savings for retirement. Firstly, if workers save for their pensions, they may loose out on getting a state pension as it is only granted to a person on provision that the applicant passes a means test. For those consumers who will not obtain social benefits if they are forced to save, there should be legislation in place that if one will be made worse off by having savings, that is if the amount they will get at retirement will be less than the state pension, then they should obtain some form of social assistance to make them just as well off as if they had been granted a full state pension. Another suggestion to encourage savings would be to give the individuals that save for their retirement social benefit from the state as well to add to the earnings they receive from their own savings. The government could perhaps pay each person who has saved, an additional amount which maybe 25% of the pension grant per month to reward the individual for saving. The logic behind this is that if the individual did not save, the government would have had to pay a full pension grant, which is greater than the 25% government will have to pay in order to reward the individual for saving. This implies that the government will have a reduced social burden than if individuals did not save.

b) Areas of concern- Spending of accumulated savings

"Even workers who save for retirement often cash in their savings when they change jobs, leaving them unprotected later on" (Fisher-French (2007:1). There are also consumers who purchase savings products and surrender them before maturity dates. A proposal would be that in order to prevent those who change jobs from spending all the money they have already accumulated for retirement and also those that surrender their savings products before maturity, legislation should be put into place that they should only be allowed to take a portion of their saving and leave the rest for retirement. This would ensure that there is an amount being saved by the individual and that will decrease the burden on the state to provide pensions out of their overly stretched coffers.

6. Lessons from other Countries-China

"China's savings rate is high because the country's social safety net is thin and most Chinese must pay for health care and pensions out of their own pockets", this is according to Lane and St-Maurice (2006:6). Now this would definitely cause consumers to save in South Africa because consumers would not be able to rely on government to provide social assistance for their medical care or pensions.

a) Implementation in South Africa

In the South African context one has to consider the extreme poverty that some members of the population live in and also the redistributive aspects of providing social assistance. Unfortunately, the government still has to first redress the wrongs that were caused by the previous apartheid government before implementing what China has in place. The government also has a responsibility to provide the rights that the population is entitled to within the availability of resources, in accordance with the Bill of Rights. With the slow service delivery of the government, one cannot ascertain as to how long it will take for government to put the members of the population who have been made worse off by the previous injustices back in the position they would have been in had they not been victims of the injustices or perhaps even provide them with their basic rights (Black et al 2006:60), but this can be considered in the long run, and perhaps there could be a gradual phasing out of social assistance as its redistributive effects better the poverty situation in the country.

7. Conclusion

The way forward is: first increase the interest rate for savings to reward consumers for saving and simplify the financial services sector to make it user-friendly, decrease the availability of credit to individuals by only allowing an individual to only have one credit card and only allowing credit purchases for basic needs, and decrease social security benefits by only increasing their spending by an inflationary increase. The tax environment should be made more savings friendly through abolition of tax on workers' retirement funds for individuals who have a low savings level, tax exemption of interest income received by individuals and the abolition of Secondary Tax on Companies (STC).

Another vehicle that South Africa can use to increase savings is forced or mandatory savings. This initiative however does have areas of concern, such as individuals loosing out on state pensions, however this may be addressed by giving social assistance to those who will have pensions which are lower than the state pension or by rewarding those who have saved by giving them lower pension grants in addition to their savings. Another concern is the spending of accumulated retirement savings by those individuals who change jobs or surrender their saving products before maturity date, which can be addressed by putting in legislation which only allows the individual to be able to cash out a certain portion of their accumulated savings.

A lesson can be taken from China, which has a high savings rate because the individuals there have no medical care and pension provided by the state. In South Africa, this may also be implemented, however one has to consider the extreme poverty that some members of the population live in and the redistributive effects of social assistance. This solution to the savings problem may be considered in the long run by decreasing social assistance as poverty is decreased through redistribution.

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