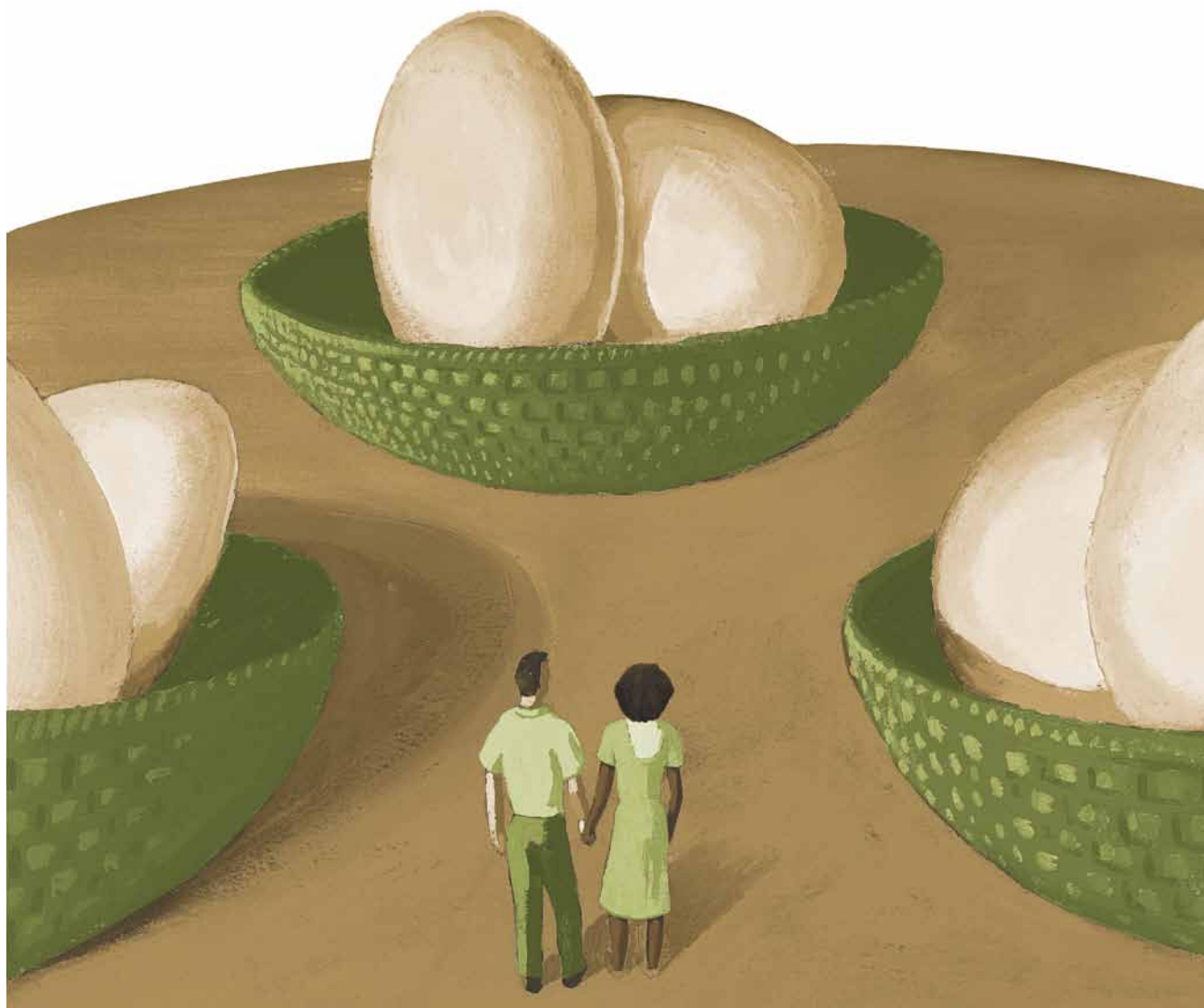


 RESEARCH


# Savings culture for the black middle class in South Africa

by Mark Cronjé and André Roux

High levels of gross national savings reduce a country's reliance on and exposure to the unpredictable global capital market. In South Africa, unfortunately, the savings levels are rather low, which makes the country dependent on foreign investment to finance the capacity for future growth. Such dependency is not always healthy, as foreign investors often withdraw at

the slightest hint of bad news. On the level of the individual, curbing excessive consumption and making provision for personal future well-being is necessary both for maintaining and improving quality of life, as well as for relieving the state of the burden to provide. At present, South African policymakers realise that the level of personal savings is far too low and they are investigating

ways to encourage savings and temper inordinate levels of consumption.

It is not unexpected for a developing economy, which is characterised by low personal income growth, to exhibit lower rates of aggregate and household savings. However, a worldwide study of regional national savings shows that this reasoning does not necessarily hold. Whereas

## SAVINGS IN THE ECONOMY

Gross **national savings** are represented by the difference between gross national income and gross national expenditure. In other words it is the amount of income in an economy that is not spent on consumption in a given year, but is put to use in a way that will provide returns to the economy in the years to come. National savings are the sum of corporate savings, public or government savings, and household or personal savings.

**Corporate savings** are measured by the value of corporate profits that are not distributed, but retained for further capital investment.

**Public savings** are tax revenues less public expenditure on recurring expenses.

**Household savings** are defined as that part of after-tax income that is not used for current consumption. There are two categories of household savings, namely contractual and discretionary savings. An example of contractual savings is the commitment to a series of payments, such as premiums on an assurance policy. Discretionary savings, on the other hand, refer to savings done on a voluntary basis.

low savings rates are widespread in the emerging economies in Sub-Saharan Africa, South and East Asian countries have, in contrast, shown quite substantial improvements in savings rates.

India and China, which are considered to be developing economies like South Africa, have particularly high national and household savings ratios. Why is this so? Can South African policy makers not learn some lessons from India and China and come up with measures to discourage consumption and create a savings culture? These questions prompted the University of Stellenbosch Business School (USB) to examine the situation in more depth. Because both India and China have burgeoning new middle class populations, like South Africa with its growing black middle class, this study placed specific emphasis on this segment of the economy.

This research aimed to develop guidelines and make recommendations for policy design and implementation in support of creating a savings culture in South Africa. It further attempted to contribute to the current discourse about the efficacy of policy structures and the accessibility of financial services and financial institutions to all sectors of the population. While classical savings theories like those of Keynes and Modigliani provide some insight into saving and consumption behaviour, they fail to deal with the full spectrum of factors that drive savings in modern-day economies, especially the non-policy determinants.

### Lessons from India and China

The research comprised a comparative study of the determinants of household savings behaviour in China, India and South Africa, with specific reference to the middle class consumer in each country. The comparative analysis drew on secondary sources such as journal articles, books, and other research reports published by reputable institutions.

### Can South African policy makers not learn some lessons from India and China and come up with measures to discourage consumption and create a savings culture?

Conventional theories would ascribe the savings propensity to variables such as: interest rate in real terms, economic growth, the level of per capita income, the spread of banking facilities, and the rate of inflation. Although economic growth plays a role, the mentioned factors were not necessarily the most influential factors in the two countries.

### Determinants of savings in India

The following factors were identified as being the reasons for the current, and continued, high levels of saving in India:

**Financial deepening.** During the last two decades India has strengthened its financial sector. This has also brought about better vehicles for investing in financial assets. Statistics show that households have increasingly put their savings in financial assets.

**Demographic variables.** A large pool of the younger population has gradually entered the labour market, especially in the production sectors. This has not only signified a larger national income, but has also decreased the dependency ratio. This ratio is an aspect of a country's demography that is pertinent to emerging market economies and is measured as the share of the population that falls outside the employable age – which typically is 15-59 years. A high dependency ratio has a negative effect on private savings rates.

The level of private savings also usually increases with a higher share of agriculture in the GDP. A large portion of India's GDP stems from agriculture, as a large proportion of the population of India lives in rural areas. Rural households experience more income uncertainty and such uncertainty brings about the precautionary motive in households to save.

**Human development.** India's emphasis on tertiary education has transformed the manufacturing sector into a skills-intensive industry. India's Human Development Index (HDI) increased from 0.513 at the beginning of the 1990s to 0.571 at the end of the 1990s and further to 0.618 by 2005-06. The education focus has resulted in an abundance of skilled labour at low cost, which enables the delivery of a better value-to-cost ratio than in other comparable countries.

**Poverty alleviation.** In spite of wide variations in the incidence of poverty across states in India, and between the rural and urban areas, there has been an impressive decline in poverty in the country as a whole. There was a significant decline in poverty between 1977-78 and 1999-2000 with the proportion of people living below the poverty line decreasing from 51.3% to 26.1%. »

### Determinants of savings in China

In China, the following variables are recognised as key determinants of its high levels of household savings:

**National tradition and culture.** Saving is inherent to the Chinese culture. It is an influence that stems from Confucianism causing households to appreciate the virtue of thrift and to question extravagant expenditure. This philosophy is demonstrated in households with a higher propensity to save than to consume. In East Asian countries like China, there are close bonds between family members, and society places a high value on the family's obligation to provide for the needs of its members. Providing for the needs of the old, raising children and providing for their education and skills training is a responsibility that is carried by the Chinese family.

**The demographic transition in China – largely caused by the one-child policy of the 1970s – has increased the proportion of working adults to young dependants**

**Demographic variables.** China's young and old age dependency ratios are currently low by international standards, a factor that tends to increase the savings rate. The demographic transition in China – largely caused by the one-child policy of the 1970s – has increased the proportion of working adults to young dependants. This measure to control the growth of the Chinese population has however increased the aging of China's population. This may result in a downward pressure on savings later as this process works itself through.

**Precautionary savings motive.** China has an inadequate social security system. Many households are uninsured against medical costs and do not have access to pension funds. It is up to households to put a significant portion of their income away to cover their medical and retirement needs.

**Lack of financial sector development.** The financial sector in China is also under-developed. In a certain sense this keeps consumers credit-constrained, a factor that largely contributes to higher savings rates. Thus, instead of being able to borrow against future income, Chinese households have to save to purchase durables and items such as houses and cars. In China, consumer loans make up only 13% of the total outstanding debt in the banking sector.

### In conclusion

It was apparent from this study that the high household savings rates in India and China are not a function of policy reforms introduced specifically to encourage saving. Rather, other factors such as the absence of sufficient financial sector development and a weak social safety net have motivated households to save to ensure adequate provision for future needs. Perhaps the most important factor is a cultural heritage that values saving of the income ahead of consumption, especially among middle class families in China.

It is widely recognised that the banking sectors in both India and China are not adequately developed. It has been suggested by policy commentators that both India and China have to strengthen their financial sectors in order to support efficient capital allocation and meet the needs of savers. Despite this apparent weakness, households are persistent in saving high proportions of their income.

### The situation in SA

South Africa, in contrast to many other developing countries and especially India and China, has a culture of debt rather than one of saving. Debt drives consumption levels upwards, resulting in low savings levels. Evidence shows that South Africa's domestic savings levels have exhibited a downward trend for the last two decades. This is worrying. For the economy to sustain growth targets of more than 4% per year, the South African government has set a target of a national savings rate of 23% of gross domestic product (GDP). In 2009, this figure was in the order of 17%.

Whereas the middle class populations in both India and China are strong drivers of savings, the situation in South Africa is somewhat different. The black middle class in South Africa has gained economic significance over the last decade and this sector is likely to continue growing into an



even stronger economic force in years to come. However, the spotlight has been on the black middle class mostly as a growing source of consumer spending. Little emphasis has been placed on this class as a driver of saving – an aspect that is perhaps overdue.

A number of factors have been shown by the study as determinants of the present lack of savings inclination in South Africa. These include the following:

**Demographic trends.** In general, populations with high growth rates are likely to have lower savings rates owing to the prevalence of high dependency ratios (either young or old age.) The aging South African population has resulted in an increase in the old age dependency ratio, which has contributed to the decline in private savings. Another factor is the trend of urbanisation in South Africa, the incidence of which usually impacts negatively on household savings.

**Income inequality.** The South African economy is characterised by income inequality. The majority of the population has very little income. Much of their concern is immediate survival and they show a high propensity to consume rather than to save for the future. The recent slowing of real household income growth against higher costs and tax obligations will leave households with an even lower propensity to save.

**Social security safety net.** A rather flawed social security system has resulted in a failure to provide broad-based income protection for all South Africans. This is leaving many citizens, even middle class households, with inadequate means and facilities to save. »

**Financial liberalisation.** Critics are in agreement that financial liberation has played a major part in the low savings in South Africa. The process gained momentum with the deregulation of financial institutions during the 1980s together with, inter alia, interest rate liberalisation, elimination of credit ceilings, the increased extension of credit to individuals, and ease of entry for foreign financial institutions. Financial liberalisation often results in higher interest rates, which theoretically should encourage private saving. However, the negative impact of higher interest rates on disposable income tends to neutralise the attractiveness of higher returns on savings. The freer access to credit has afforded households the opportunity to maintain higher levels of consumption than would otherwise have been possible, which has naturally discouraged savings.

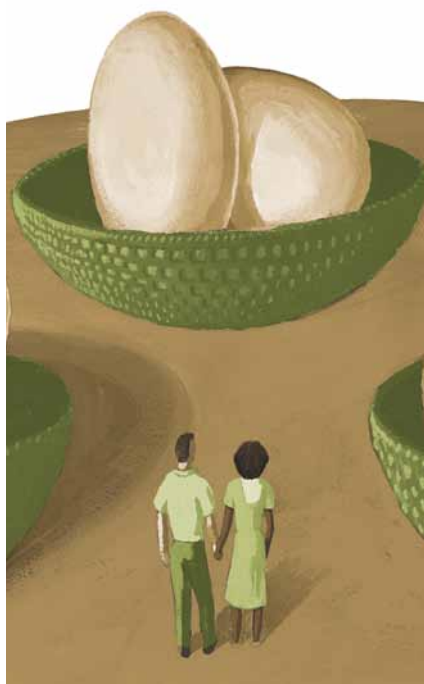
### What should SA do?

The fact that low levels of saving can be attributed to structural factors like shifts in urbanisation, demography and financial liberalisation makes it increasingly difficult for change to be effected through public policy alone. A more encompassing approach is necessary.

### Innovative savings instruments that are simple and affordable and that reward investment are needed

While increased access to credit may negatively affect private savings levels, one must not lose sight of the positive role financial liberalisation can play in the development of a country's financial sector and the indirect benefits it can have on savings levels. The liberalisation of domestic financial markets, along with the strengthening of the country's banking sector, will improve the efficiency of financial intermediation, and thus investment, contributing to higher growth. These factors will stimulate and support an increase in private savings in the long run.

The financial sector needs to reform – not to further deepen the sector to encourage consump-



tion – but to provide better access to structures that encourage both consumer investment and saving. In particular an emphasis on improved access to and use of savings instruments by South Africa's growing black middle class is required. Innovative savings instruments that are simple and affordable and that reward investment are needed.

In addition to financial sector reform, government should take action to establish a more coherent social security structure. Such a structure should be made widely accessible, it should be cost and tax efficient and it should be backed by continued government investment. Along these lines, government should reform the retirement funding landscape through the creation of an inclusive, broad-based retirement provision platform.

In respect of the potential role of a national policy, a number of recommendations can be made to stimulate higher savings, and to help cultivate a savings culture in the broader South African population.

These recommendations are:

- a targeted, holistic fiscal policy to encourage and facilitate savings;
- an increase in government investment in social security and retirement; and
- consideration of suitable tax incentives to encourage and reward contribution to the savings instruments.

It is recognised by economists that any potential reforms, such as those listed, should be supported by a continued tighter control of household access to credit and credit extension. While credit-funded consumption is needed to stimulate economic growth, it remains vital that credit extension be subjected to a robust application process to ensure that households can reasonably afford the obligation, and that the ability to save is not sacrificed.

But there is an equally, if not more important aspect. It is evident that in India and China – where many of the formal structures and reforms are wanting – much depends on an appropriate mindset. Perhaps the most pressing need lies with education and conditioning. It is critical that individuals are suitably equipped to make informed decisions about financial choices. Without ignoring the needs and consumption pressures of low income households, people should be given access to financial education programmes. Such programmes should be designed to disseminate information in user-friendly ways and to provide fertile ground for behaviour change. Not only should information be directed at an awareness of available financial instruments and the value of savings, it should also build in sufficient warning against falling into excessive debt patterns. ■



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This study was conducted by Mark Cronjé as his MBA research project at the University of Stellenbosch Business School (USB), under the supervision of Prof André Roux. The research report, *Creating a savings culture for the black middle class in South Africa – policy guidelines and lessons from China and India*, was presented in December 2009.