Private sector saving in South Africa

by J.W. Prinsloo

Introduction

A satisfactory rate of economic growth normally requires an adequate rate of investment and therefore, an adequate supply of savings. A heightened concern with investment was prompted during the 1970s by slow productivity growth in most developed countries. The implications this had for real income growth, together with the inability of many economies fully to absorb a growing labour force, was seen in a serious light by policy-makers. Higher saving and investment were widely proposed as the remedy for these weaknesses in the production structures of industrial economies.

During the second half of the 1980s, in particular, the South African economy experienced a fate similar to that of the global economy. The national savings rate fell to a low level and a sustained inflow of capital into the country was turned into a net outflow of capital from the country. The growth potential and employment-creating capacity of the economy deteriorated badly. It is therefore not surprising that increasing concern has, from time to time, been expressed by policy-makers and economic analysts of South African conditions about the low levels of domestic investment and savings ratios.

This article aims to present an overview of savings trends in South Africa over the past almost three and a half decades in order to obtain a better understanding of the lower savings ratio of the country. The focus is primarily on the determinants of private-sector saving and the likely effects of tax and other policies on the saving decisions of private-sector agents.

The importance of saving in the national economy is discussed in the first section of this article. The definition and measurement of saving in the national accounts are then summarised in the second section. This is followed by an overview of trends in domestic saving since the beginning of the 1960s and by a description of the more important determinants of savings behaviour. The likely outcome of measures to strengthen the national savings rate is discussed briefly in a subsequent section before some concluding comments are made.

The importance of saving in the national economy

Saving provides the wherewithal for capital formation which, in turn, is essential for economic development. Investment is widely accepted as a goal of economic policy because it allows producers to take advantage of technological progress, increases the productivity of workers and consequently real wages and thereby allows for the permanent improvement of the standard of living of the population.

In a closed economy with no foreign trade,

investment would equal savings. In an open economy that trades with other countries, it is possible for an imbalance to exist between domestic saving and domestic investment. The difference between domestic saving and investment is then reflected in the surplus or deficit on the current account of the balance of payments. When domestic investment exceeds domestic saving, the shortfall becomes visible in a deficit on the current account of the balance of payments, which must be financed by importing saving from other parts of the world - i.e. by means of an inflow of capital from abroad - or by running-down the country's stock of foreign reserves. This indicates that a part of the adjustment to an imbalance between saving and investment may be in the form of changes in the exchange rate.

In many countries around the world, experience has shown that the pursuance of a cheap money policy with credit abundantly available at low cost will end in a spiral of successive depreciations of the currency and escalating inflation. A sufficiently strong saving performance is therefore an important precondition for macro-economic balance and the maintenance of financial and price stability.

In the public debate on appropriate economic policies for South Africa it is often argued that additional investment, and therefore saving too, is needed to foster long-term economic growth. Some participants in this debate apparently believe that an increase in the savings rate provides a means to accelerate the rate of output growth *permanently*. In reality, however, an increase in the share of domestic income devoted to saving and investment does not necessarily affect the growth rate indefinitely if it is not accompanied by changes in the production structure or by technological progress resulting in improved techniques or organisation of production.

A higher saving and investment level can nevertheless raise the *level* of output per worker, and during the transition from a lower investment level to a higher one it would also raise the growth rate temporarily. It must also be taken into account that the portion of domestic income allocated to saving, cannot be increased indefinitely. The saving ratio of a community is determined by the optimising decisions of many individual households which ensure that a major portion of current income will always be consumed.

Towards the end of the 1970s, the need for higher global savings rates was viewed in a serious light when real income growth slowed down in virtually all the rich countries of the world. The increase in the propensity to spend was then no longer seen as the start of a virtuous multiplier process of increasing aggregate demand. On the contrary, it was viewed as a structural deficiency which prevented economies from increasing their capacities to produce. The saving shortfall in the rich countries since the late 1970s was aggravated, firstly, by the financing needs of Third World countries and, secondly after 1989, by the economic restructuring of formerly communist countries in Eastern Europe and the former Soviet Union. It was feared that real interest rates will be pushed higher by these global financing requirements and that this may suppress real fixed investment. In this manner, lower global saving means lower investment and slower real income growth throughout the world.

Definitions and measurement of saving in the national accounts

Gross domestic saving in the national accounts represents that portion of total income generated during a certain period, which is not consumed during that period. Saving is retained income resulting from the postponement of consumption. It is measured as a balancing item in the current income and outlay accounts of the domestic institutional sectors, i.e. private households, companies and the general government. Capital gains and losses as well as profits or losses made from the revaluation of financial or fixed assets, are excluded from saving in the national accounts. Net domestic saving is equal to gross domestic saving less the provision for depreciation. Net domestic saving comprises net public- and private-sector saving. Private saving, in turn, consists of personal and corporate saving.

In the national accounts the saving from each of the above sectors is consolidated and represents that part of gross national disposable income which has not been spent on private and government final consumption. Gross national disposable income encompasses the receipts by residents of income from employment, entrepreneurship and property, less net factor payments to the rest of the world, plus net current transfers from abroad. Current transfers to a country are normally included in the income from which saving is calculated. Capital transfers, however, are not, but are considered as a source of finance because they supplement saving in the recipient country. National disposable income represents the amount available for consumption expenditure and saving, the latter, in turn, being available for the acquisition of capital assets of one kind or another.

In South Africa's set of national accounts a distinction is drawn between personal saving, corporate saving, general government saving and allowances for asset depreciation.

Personal saving

Personal saving, or saving by households, includes the retained income of unincorporated business enterprises and retained income of non-profit institutions serving households. All the income of pension funds is attributed to households. In the case of life insurance companies, part of their net income is allocated to households as interest added to the equity of policy-holders. Any portion of current expenditure of households not financed by current income but rather by the use of credit, represents an increase in the financial liabilities of individuals and is treated as negative saving. Therefore, personal saving in the national accounts is also defined as the surplus of total saving by households over the use of consumer credit.

Personal saving is usually divided into two categories, namely contractual and discretionary saving. Contractual saving involves individuals committing themselves to a series of payments such as premiums on insurance policies, contributions to pension funds and the capital amount payable on households' mortgage loans. Discretionary saving, in contrast, refers to types of saving where households are not bound by any fixed commitments. All contractual saving normally stems from discretionary saving to the extent that contractual obligations are made on a voluntary basis. An exception is where the employee is bound by a contract of service to contribute to a pension fund.

Because of the inadequacy of data sources, the direct estimation of personal saving from the income and expenditure account of households will be subject to a considerable margin of error. Rather than introduce an additional statistical discrepancy to the national accounts, it is assumed that the national accounting identities hold precisely, and that all the other components of aggregate domestic saving can be estimated with a greater degree of accuracy than personal saving. Personal saving is accordingly derived as the balancing item on the capital finance account.

The capital finance account sets out the ways in which residents accumulate physical capital and the ways in which they finance this accumulation. Gross fixed investment and changes in inventories are the means of accumulation. Gross domestic saving is the main domestic source of finance. The other principal source of finance is the transfer of saving from the rest of the world. After having identified such transfers and the contributions to domestic saving by the corporate sector and the general government, saving by the household sector is derived as a balancing item on the capital finance account.

The national-accounts estimates of personal saving do not distinguish between contractual and discretionary saving, but tentative estimates of contractual saving are often prepared from the consolidated income statements of pension funds and long-term insurers. Although differentiation between contractual and discretionary saving is not important from a macro-economic point of view, increases in contractual-type saving accompanied by a corresponding increase in the financial liabilities of the household sector will leave total personal saving unchanged. It will only cause a rearrangement in the saving portfolio of the personal sector.

Corporate saving

Saving in the corporate sector is the balancing item between the income and expenditure accounts after the current receipts and payments of companies have been taken fully into consideration. It could also be described as the retained income of private and public incorporated financial and non-financial enterprises.

Corporate saving is estimated as the sum of the gross operating surpluses of companies, less the net dividend, interest, rent and royalties payable by them to the other sectors of the economy and to the rest of the world, less direct taxes and other net transfer payments made to the general government, the household sector and the rest of the world. Corporate saving calculated according to these guidelines represents gross corporate saving. Net corporate saving comprises gross corporate saving after provision for depreciation and inventory valuation adjustment. The latter is the difference between the change in the book value of inventories and the physical change in inventories valued at the average prices prevailing during the period of change. This difference is a measure of the net gain or loss realised on inventories by businesses as a result of price changes. Gains and losses on inventory holdings form part of corporate profits before taxes, and must be excluded in order to measure current production and actual saving by the corporate sector.

Saving by general government

Saving by general government is the total of retained profits of public enterprises and retained taxes and other current receipts not disbursed on current outlays of government. In contrast to households whose income consists mainly of factor income, income of the general government consists of current transfers received from the private sector in the form of tax revenue and all current non-tax revenue. Tax revenue embraces all direct and indirect taxes, and non-tax revenue includes income from property, the cash operating surpluses of departmental enterprises, and some other current receipts such as fines and forfeitures.

On the expenditure side, current government expenditure includes all current outlays for goods and services by general government, covering wages and salaries of government employees and outlays on other non-capital goods and services. This component also includes defence expenditure and an imputed expense for the capital consumption of fixed assets by general government. Interest payments on public debt, subsidies and other transfers to the household sector and the rest of the world form the remaining part of current expenditure by general government.

Provision for depreciation

Gross domestic saving includes provision for depreciation, or capital consumption allowances. In national accounting terms, the consumption of fixed capital can be defined as that part of the gross value of production which is required to replace fixed capital consumed in the process of production. This flow is based on the expected economic life of the individual asset and covers the loss in value due to foreseen ageing and normal wear and tear.

Estimates of depreciation allowances in the national accounting tables are calculated from national investment totals at constant prices and then converted to replacement values in order to make an assessment of the use of capital assets at prices prevailing in the year that consumption of capital actually takes place. These estimates may differ substantially from the depreciation changes provided for in the accounts of private-sector companies.

Trends in gross domestic saving

From the information provided in Table 1 and Graph 1, it is apparent that gross domestic saving in South Africa averaged 23,8 per cent of gross domestic product in the period from 1960 to 1993. In recent years, starting in 1986, a distinctly downward trend in the aggregate saving rate became discernible. As a result, the average saving rate in the period 1985-1993 fell to 21 per cent, compared with 23,3 per cent in 1960-1972 and 25,7 per cent in 1973-1978. During the period 1979-1984 the saving rate was at a higher average level of 27,1 per cent, but saving behaviour during that period was strongly influenced by the windfall profits of gold-mining companies, when the price of gold reached exceptionally high levels.



Graph 1: Gross domestic saving as a percentage of gross domestic product

Year	Private households	Private corporate sector	Total private sector	General government	Total gross domestic saving
1960	6,0	9,4	15,4	6,5	21,9
1961	10,2	8,7	18,9	5,3	24.2
1962	11,9	8,9	20,8	3,6	24,4
1963	9,6	8,7	18,2	7.0	25,2
1964	6,6	10,1	16,7	6,7	23,4
1965	6,8	9,4	16,2	5,9	22,1
1966	8,3	9,3	17,7	5,1	22,7
1967	8,3	8,4	16,7	7,3	24,0
1968	9,3	8,6	17,9	6,8	24.7
1969	6.6	9.2	15,8	6.8	22.6
1970	6,2	8,3	14.5	6,1	20,6
1971	9.5	8.6	18,1	4,5	22.7
1972	10.1	9.5	19.7	5.1	24.8
1973	6.3	11.1	17.4	7.7	25.1
1974	6.3	11.3	17.7	7.8	25.5
1975	8.3	11.2	19.4	5.9	25.4
1976	5.7	13.0	18.7	4.3	23.0
1977	9.6	13.7	23.3	4.2	27.5
1978	7.3	15.4	22.7	5.0	27.7
1979	9.6	18.2	27.8	4.5	32.2
1980	8.8	19.5	28.4	6.1	34.5
1981	3.9	18.3	22.1	5.1	27.2
1982	4.0	13.9	17.8	29	20.8
1983	4.1	18.4	22.5	29	25.3
1984	5.4	15.7	21.2	14	22.5
1985	6.9	160	22.9	16	24.5
1986	5.3	169	22.0	13	23.5
1987	6.2	15.9	22.1	0.4	22.5
1988	57	15.6	21.3	1.4	22,0
1989	54	15.6	21.0	15	22.6
1990	40	14.4	18.4	12	19.5
1991	4.5	14.2	18.6	03	18.9
1992	59	15.0	21.0	-4.0	17.0
1993	6,2	15,6	21,9	-4,4	17,5
Averages					
1960 - 72	8.4	9.0	17.4	5.9	23.3
1973 - 78	7.3	12.6	19.9	5.8	25.7
1979 - 84	6.0	17.3	23.3	3.8	27.1
1985 - 93	5.6	15.5	21.0	-0.1	21.0
1960 - 93	70	12.8	10.0	30	22.8

Table 1. Components of gross domestic saving as percentage of gross domestic product

In Table 2 South Africa's savings rate is compared with that of a number of developed industrial economies. Until the mid-1980s South Africa's saving relative to gross domestic product compared favourably with that of the other countries included in the table. In fact, South Africa's ranking among the eleven countries improved from ninth in the years 1961-1972 to sixth in 1973-1978 and then to fourth in 1979-1984. In recent years, however, South Africa's savings ratio has been exceeded by that of most of the other countries.

South Africa's average savings rate in the 1980s and early 1990s broadly corresponds with the average savings rate of other middle-income economies, i.e. economies with an average income per capita between US\$2 000-3 000.

Period	Australia	Canada	France	Japan	United Kingdom	Austria	Germany	United States	Portugal	Switzer- land	South Africa
1961-72	29,2	23,9	25,1	35,8	18,4	28,5	26,6	16,2	26,0	31,0	23,5
1973-78	27,5	26,0	24,2	33,1	21,9	28,1	21,1	17,4	27,8	24,2	25,7
1979-84	28,6	21,9	21,5	30,1	14,5	24,9	21,0	18,4	31,0	23,6	27,1
1985-92	26,5	23,4	20,8	30,6	21,1	24,8	19,4	17,3	27,7	24,0	21,0*

Table 2. Gross domestic saving for selected countries as percentage of gross domestic product

* Period 1985-93

Source: IMF, International Financial Statistics (various issues)

On average, the savings rate of these middle-income economies was, at 24,2 per cent, only one percentage point higher than that of South Africa. In the period since 1980 South Africa ranked sixth among the eleven individual developing countries listed in Table 3. Since 1985, however, South Africa's savings rate deteriorated more rapidly than the savings rate of those countries listed in Table 3 and on average also weakened against the performance of the middle-income economies.

The somewhat abrupt weakening of South Africa's saving rate towards the middle of the 1980s coincided with a reversal of net capital movements into the country. Until 1984 domestic saving was generally augmented by an inflow of capital from the rest of the world. There were times, such as the years 1960-1963 and 1977-1980, when the country suffered a net outflow of capital, but these periods were relatively short-lived and were soon followed by renewed inflows of capital. Since 1985, when the decline in the aggregate savings rate began, it has been accompanied by an unbroken series of annual outflows of capital. As a percentage of

gross domestic product, these outflows amounted to 2,5 per cent. In previous years South Africa could still expect an inflow of capital from the rest of the world, averaging about 1 per cent of gross domestic product.

Quarterly movements in the ratio of aggregate gross domestic saving to gross domestic product are indicated in Graph 2, along with the successive upswings and downswings of the South African business cycle. Although the cyclical behaviour of the gross domestic savings ratio does not appear to be entirely consistent, the general tendency is for the domestic saving rate to strengthen relative to gross domestic product when the economy is in a downward phase of the business cycle and to weaken when economic activity is expanding. A notable exception was the upswing phase of 1978-1981, when the rising price of gold caused windfall profits to be saved by the gold-mining industry and the overall national savings rate improved. An even more striking exception to the regular pattern is the continuous decline in aggregate gross domestic saving relative to the gross domestic product over

Table 3.	Gross domestic saving for developing and middle-income economies as percentage of gros	SS
	domestic product	

Country	Period	Average savings rates	Period	Average savings rates
Argentina	1980-92	16,3	1985-92	14,6
Botswana	1980-89	25,1	1985-89	32,1
Brazil	1980-90	23,3	1985-90	25.2
Chile	1980-91	17,9	1985-91	21,6
Hungary	1980-92	26,7	1985-92	25,4
Iran	1980-91	21,0	1985-91	18,6
Malaysia	1980-91	32,8	1985-91	33,6
Mauritius	1980-91	20,7	1985-91	24,5
Mexico	1980-92	24,0	1985-92	22,0
South Africa	1980-92	23,2	1985-93	21,0
Turkey	1980-91	18,7	1985-91	20,8
Middle-income economies	1980-90	24,2	1985-90	23,5

Source: World Bank, World Tables, 1993

Table 4.	Gross domestic saving and net capital
	inflows from abroad as percentage of
	gross domestic product

Period	Gross domestic saving	Net inflow of capital not related to reserves	
1960-72	23,3	1,8	
1973-78	25,7	1.6	
1979-84	27,1	0,5	
1985-93	21,0	-2,5	

the recent very long downswing from 1989 to 1993.

A strengthening of the saving propensity of the private sector appears to be a natural response during times of relative adversity. Weaker income growth and a general lack of job-security during recessionary times is likely to instill a sense of caution and frugality among households. The most probable outcome then is for spending growth to be curtailed and for saving to move higher. Conversely, a deterioration in the savings rate can be expected during an economic upswing when consumers feel more secure and are more inclined to increase their current consumption outlays.

General government saving is likely to move in the opposite direction from private-sector saving. In times of economic recession, government tax revenues grow

Graph 2: Quarterly gross domestic saving as a

more slowly or may even decline as business activity wanes. At the same time, public-sector spending may increase faster as a result of deliberate spending policies aimed at the stabilisation of aggregate domestic demand, or because of increased social security spending and the payment of unemployment benefits. These may serve to reduce saving by the general government during downturns of the business cycle. In contrast, general government saving may improve during upturns as tax revenues increase and public-sector spending slows down relative to the growth in the gross domestic product. These opposing changes expected in government and private-sector saving make it difficult to come to any a priori conclusion about the cyclical behaviour of the aggregate domestic savings ratio. They also explain why the cyclical movements of the aggregate domestic savings rate in successive upswings and downswings are not fully consistent with one another.

The private savings rate in South Africa has been relatively firm since 1960. In fact, it has trended slightly upwards over the past thirty-four years. A linear growth trend over the years 1960-1993 fitted to the annual ratios exhibits a slight upward tendency.1 In the period 1985-1993 gross private saving as a percentage of gross domestic product averaged 21 per cent, compared with 17,4 per cent in 1961-1972.

The relative stability of the overall private-sector

The slope coefficient of a log-linear straight line fitted to the saving rate over the period 1960-1993 was calculated at 0.01.



Graph 3: The components of gross private-sector saving as a percentage of gross domestic product



60 62 64 66 68 70 72 74 76 78 80 82 84 86 88 90 92

savings rate conceals the changes in the composition of private-sector saving during the 1980s – see Graph 3. Gross saving by private households relative to gross domestic product has been declining steadily since the 1960s. Household saving as a percentage of gross domestic product in the years 1985-1993 amounted to 5,6 per cent, compared with 8,4 per cent in 1960 -1972. This declining tendency is mirrored by an increase in private corporate saving from 9 per cent of gross domestic product in 1960-1972 to 15,5 per cent in 1985-1993.

The shift in relative importance from household saving to corporate saving is also apparent in the declining average propensity to save from disposable income – see Graph 4. In the 1960s and early 1970s households saved on average 9,3 per cent of their annual disposable income. This percentage dwindled to 3,7 per cent in the years 1985-1993.

Unlike the relatively stable behaviour of the private-sector savings ratio, gross saving by general government as a percentage of the gross domestic product declined over the years since 1960. In the years 1960 - 1972 the saving by general government was equal to 5,9 per cent of gross domestic product, but in the years 1985 to 1993 it changed from positive saving amounting to 1,6 per cent of gross domestic product, to dissaving amounting to 4,4 per cent. Since 1991 gross saving by the general government has turned into gross dissaving, in the sense that current expenditure has consistently exceeded current revenue.

Viewed over the entire period since the 1960s it is clear



that the weakening during the 1980s of the overall gross domestic saving rate should be blamed mostly on the decline in government saving. The relative stability of the private-sector savings ratio over a fairly long period of time may also indicate that it would be difficult to alter private-sector savings behaviour by some adjustments in tax policies. In addition, the stable overall *private-sector* saving rate lessens to some extent concerns expressed about the declining *private-household* saving rate.

The determinants of private-sector saving

Most studies attempting to identify the determinants of savings behaviour rely on some variant of the life-cycle or permanent-income hypothesis. According to these theories, households maximise the benefits of consumption over their lifetime, subject to the constraints of expected lifetime income and initial wealth. Interest rates indicating the terms of the tradeoff between current and future consumption, demographic variables and wealth are accordingly singled out as potential causes of change in consumer behaviour. Other determinants include changes in average income levels, the distribution of income among households and the ability of individuals to "pierce the corporate veil".

Real after-tax interest rates

There is no general agreement among economists about the impact of a rise in the real after-tax interest rate on decisions to consume or save. A rise in the rate of return on accumulated saving increases the opportunity cost associated with current consumption and should raise the savings rate. At the same time, the future income stream expected from this higher rate of return on saving may encourage current consumption. Because these two forces (i.e. a substitution effect and an income effect) are working in opposite directions, the net effect of a change in the rate of return cannot be determined with certainty.

Rising marginal personal tax rates together with persistently high inflation eroded the real after-tax rate of return on deposit-type saving in South Africa severely during the 1980s. Table 5 indicates that the average marginal tax rate of individuals increased from 10,2 per cent in 1971 to 19,1 per cent in 1981 and then to 31,6 per cent in 1991. An amount of R100 invested at the beginning of the fiscal year 1970/71 under the assumption that interest income is capitalised at the end of each year, would have been reduced in real purchasing value to R43,75 at the end of fiscal 1993/94. This was essentially caused by the progressiveness of direct personal income tax scales and continuous inflation, which moved increasing numbers of taxpayers to higher income categories with higher marginal tax rates.

It is generally believed that the decline in households' preference for saving in the form of deposit-type investment has been adversely affected by the decline in

Year ending 28 February	Nominal interest rate	Marginal tax rate %	After-tax rate of return	Inflation rate	Real after-tax return %	Value of R100 investment
	70	<i>,</i> ,,	70	70	70	
1971	7,3	10,2	6,6	4,2	2,3	102,26
1972	7,5	15,8	6,3	6,1	0,2	102,47
1973	7,1	17,8	5,8	6,8	-0,9	101,54
1974	7,0	17,3	5,8	9,6	-3,5	98,01
1975	9,1	17,8	7,5	12,7	-4,6	93,47
1976	9,5	18,8	7,7	12,7	-4,4	89,34
1977	9,5	20,6	7.5	11,5	-3,5	86,17
1978	9,5	21,2	7,5	10,8	-3.0	83.59
1979	9,0	20,3	7,2	10,4	-2,9	81,15
1980	7,3	19,7	5,9	13,5	-6.7	75,69
1981	7,6	19,1	6,1	14,1	-7,0	70,41
1982	10,5	21,6	8,2	14,9	-5.8	66.32
1983	15,2	23,2	11.7	14,8	-2,7	64.52
1984	13,3	25,2	9,9	11.6	-1.5	63,56
1985	17.5	28.5	12,5	12,5	0.0	63.57
1986	15,7	25,7	11.7	16,9	-4.5	60.72
1987	11.4	26,9	8,3	18,1	-8,3	55,70
1988	10,4	25,9	7.7	15.7	-6.9	51.85
1989	12,9	27,7	9,3	12,8	-3,1	50,25
1990	16,6	30,8	11.5	14.9	-3.0	48,76
1991	17.0	31,6	11.6	14,3	-2.3	47,62
1992	15,8	29,2	11,2	15,6	-3.8	45,81
1993	13,2	28.1	9.5	12.9	-3.0	44.42
1994"	11,5	29,2	8,1	9,8	-1,5	43,75

Table 5. Real after-tax return for the average taxpayer of	on 12	months'	fixed	deposits
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1. The marginal tax rate of 1994 is a preliminary figure.

real after-tax interest rates. By the same token, however, this fall in the return on deposit-type investment could have encouraged the relative rise in corporate saving in the place of direct saving by households.

Demographic trends

The life-cycle hypothesis of savings behaviour indicates that the overall savings rate of an economy will be influenced by the age distribution of households. This model distinguishes between stages of the normal life cycle: dissaving among young adults engaged in education and the early stages of family formation, saving among older working adults and dissaving among retired people. Communities with large sections of the population in the younger and/or retired age group are likely to have a comparatively low savings rate. Those with a high rate of population growth will tend to have a declining savings rate.

According to population census statistics, the section of the population of South Africa in the age group 25 to 44 years increased from 25,5 per cent in 1970 to 28,5 per cent in 1991. This increase in the share of younger consumers in the total population, with their greater preference for consumption than for saving, could have contributed to the decline in the saving rate of the household sector.

Redistribution of income among households

The redistribution of real income in favour of low-income earners with a high average propensity to consume tends to increase the proportion of domestic income which is devoted to private and public consumption and thereby reduces the savings rate. Well-developed social-security systems also tend to lower the household savings rate. since they lessen the necessity to provide for old age and assorted mishaps (unemployment, sickness, disability), and consequently reduce thriftiness. In addition, the dependency ratio is high in South Africa among lowerincome earners. This means that the number of household members dependent on the income of a single income-earner is high. This situation is aggravated further by rising unemployment and extended family relationships among a large segment of South African society. These household characteristics unavoidably reduce the capacity to save.

An analysis of information contained in various

surveys of household expenditure confirms that saving from current income among lower-income households in South Africa is practically non-existent. The savings rate of high-income earning households is virtually twice as high as that of households classified as middle-income earners.

Slow income growth

Real household income growth slowed down perceptibly in the 1980s – see Graph 5. Inflation-adjusted current household income growth slowed down from 6 per cent in the 1960s to 4 per cent in the 1970s and then to 2,8 per cent in the 1980s and early 1990s.

The rising direct tax burden on individuals held back disposable income growth yet further. Real personal disposable income increased at an average annual rate of 4,9 per cent in the 1960s and 4,1 per cent in the 1970s, but then slowed to 2 per cent per year in the 1980s and early 1990s. In addition, real personal disposable income per capita receded at an average annualised rate of 1 per cent between 1980 and 1993. Therefore the maintenance of past spending habits and a reluctance to come to terms with the slower pace of income growth weakened the savings propensity of South Africa's household sector.

Deregulation of financial institutions

The deregulation of financial institutions during the 1980s created many new lending opportunities for banks and other financial institutions and afforded individuals much easier access to credit facilities. This allowed households to maintain higher levels of spending than would have been the case under different circumstances. In consequence, households' use of consumer credit facilities relative to their disposable incomes in the 1980s moved to a much higher level than in previous years – see Graph 6.

Alongside this development, the rise in asset prices disguised the rise in households' overall indebtedness. Table 6 indicates that the prices of shares listed on the Johannesburg Stock Exchange rose on average at a rate of 10,8 per cent over the period 1970 to 1993, whereas the prices of private dwellings rose at an average rate of 10,4 per cent over the same period.

As can be seen from Graph 6 the deterioration in the savings rate of households at the beginning of the 1980s coincided with the greater use of credit by private households. The lower level of the household savings rate in the 1980s and early 1990s is mirrored by the higher ratio of consumer credit to the disposable income of households. Although the direct effect on saving of the general deregulation of the financial sector in the 1980s cannot be quantified, it undoubtedly contributed to the rapid rise in outstanding credit and the resulting lower household savings rate.

It has been argued by others that the deregulation of financial institutions and high inflation created a climate which encouraged individuals to channel the bulk of their



Graph 6: Outstanding consumer credit and personal saving as a percentage of personal disposable income



Period	Houses ¹⁾	Shares ²
1970	13,90	12,20
1971	14,94	11,14
1972	15,60	15,20
1973	17,91	18,61
1974	19,44	20,54
1975	20,95	17,76
1976	22,21	15,09
1977	22,79	14,64
1978	23,46	17,94
1979	26,34	25,17
1980	32,66	41,96
1981	45,18	37,93
1982	54,74	31,90
1983	65,92	44,66
1984	71,87	46,10
1985	65,73	49,61
1986	63,03	67,30
1987	69,38	91,03
1988	79,61	68,39
1989	87,60	91,41
1990	100,00	100,00
1991	114,06	107,06
1992	124,14	112,74
1993	133,86	129,05

Table 6. Price indices of shares listed on the Johannesburg Stock Exchange and average house prices

Source:

1. Quarterly Housing Review, ABSA Bank (various issues)

2. South African Reserve Bank, Quarterly Bulletin (various issues)

savings in the direction of inflation-hedge instruments rather than in the direction of deposit-type savings instruments. The net result is that households as a whole save with contractual savings institutions and borrow from banks and other financial institutions. The net dissaving of households with these so-called discretionary savings institutions is contrasted with the saving by households with so-called contractual savings institutions in Graph 7.

The macro-economic significance of the distinction between contractual and discretionary saving is limited. The dissaving by households with discretionary saving institutions is the result not only of saving decisions taken by individuals, but also of the investment decisions taken by these institutions. Banks, in particular, have extended increasing amounts of loans to households for housing finance and consumer credit to the extent that net lending by banks to households exceeds the increase in household deposits with these institutions. To fund these lending operations, banks are relying on funds obtained in the wholesale market, amongst others from the contractual saving institutions, such as insurance companies and pension funds. Contractual savings



institutions invest mostly in marketable government and private-sector securities and allocate only a limited amount of funds to private households and individuals. The breakdown of household saving in contractual saving and discretionary saving is therefore of limited significance – it is more an institutional classification of household saving and reveals little information on the actual savings behaviour of private households.

84 86 88

90 92

Interdependence of sectoral saving

78 80 82

-10

-20

-30

-40

70 72 74 76

There are good reasons to suppose that the saving of households and companies are interrelated. The relative stability of the overall private-sector savings rate has already been noted. The explanation most often put forward for this is that households are able to "pierce the corporate veil" and perceive corporate savings decisions as essentially savings actions taken on their behalf. Corporate saving is thus seen as an extension of, and a substitute for, saving at the household level.

In their capacity as shareholders, individuals have ultimate claim to the undistributed profits of companies. The retention of corporate profits causes the net worth of companies to rise, equity prices to increase and the net asset values of households to strengthen. If capital gains are untaxed and real earnings on deposit-type investments are seen to be inadequate, saving by companies on behalf of individual shareholders will be highly attractive. Such a situation prevailed in South Africa throughout the 1980s.

Measures to strengthen the domestic savings rate

The current savings rate of the South African economy is widely regarded as too low to support a sufficiently high economic growth rate. In the *Annual Economic Report* of the Reserve Bank for 1994 it was indicated that the aggregate savings rate will have to be raised to 22 per cent of gross domestic product to support a growth rate in real incomes of 3 per cent per year. In 1993 the savings rate amounted to only 17,5 per cent of gross domestic product.

The usual way in which governments attempt to influence savings behaviour is to exempt investment income partly or in full from income tax. The idea behind this is to influence the marginal rate of return on accumulated saving in order to influence the flow of saving.

If all investment income is accorded exactly the same tax treatment, a change in the tax rate will have an identical effect on the marginal after-tax rate of return on all forms of saving. Because of the offsetting substitution and income effects, the net change in overall saving flows arising from such a tax change is uncertain. The savings rate may either be raised or reduced by such a tax change. The ability of the government to influence the private savings rate through adjustments in the after-tax rate of return on saving may therefore be very limited.

The loss of tax revenue on account of the granting of tax concessions could give rise to an increase in the budget deficit if it is not accompanied by a reduction in expenditure or an increase in other revenue. The use of tax incentives to stimulate saving may therefore turn out to be counter-productive: it may or may not increase private saving, but it will cause a loss of tax revenue and a probable decline in government saving. The overall savings rate is more likely to fall if the full benefit of the tax cut is not saved by the taxpaying community.

The effect of an introduction of differential rates of taxation on savings behaviour is to bring about a onceand-for-all shift in savings flows to those forms of saving that are favoured by the tax change. Once the tax concession is fully capitalised in the price of a financial asset, it forms an integral part of the return to the form of saving it was designed to encourage. A lasting effect on the flow of savings accordingly requires not merely the introduction of incentive measures, but their continuous improvement.

In short, tax incentives to influence savings behaviour are much more likely to influence flows to the various forms of saving, rather than to have a lasting impact on the overall savings rate of the economy. Given all the uncertainties pertaining to the effectiveness of government policies to alter private saving, direct actions to increase the domestic savings rate by cutting budget deficits and raising government saving would appear to be a much more certain prescription for success.

Conclusion

Private-sector saving relative to gross domestic product has demonstrated remarkable resilience in the long run. The average private-sector saving rate in recent years has maintained levels higher than those attained during the 1960s, when the general economic environment was much more conducive to a stronger savings performance. Nevertheless, as a result of considerations pertaining to taxation and inflation, the composition of private-sector saving has changed considerably; corporate saving now constitutes a much larger portion of total private-sector saving than before.

The weakening in the aggregate domestic savings rate during the 1980s can mainly be attributed to a weakening of general government saving, which eventually turned into net dissaving. Given the longerterm relative stability of the private-sector savings rate and the uncertainties attached to tax measures aimed at strengthening private-sector saving, the best way to improve the country's savings rate and growth performance appears to be a reduction in government dissaving – preferably for government saving to be restored to a situation where positive additions are made to private-sector saving.