Mail and Guardian

Saving is key to a healthy economy

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COMMENT

A recession is a very difficult period for any nation.

A technical indicator of it is when economic growth measured by gross domestic product (GDP) declines markedly for at least six months or when a country experiences negative economic growth for two consecutive terms. This results in several things.

First, less revenue is collected from personal and company taxes. Low government revenue results in inadequate funding for developmental projects. This has serious implications, particularly for a welfare state, in which the government plays a key role in improving the wellbeing of its citizens, especially those in financial and social need.

In most cases, in an attempt to reduce the revenue gap, it is common for states to increase taxes, although doing so can have adverse results and exacerbate negative economic growth.

Second, during a recession, the ability of the government and consumers to spend on goods and services negatively affects the private sector as sales and revenue or profits decline. A reduced aggregate demand in most cases forces the business sector to lay off employees, or forces businesses to implement shorter working times, resulting in higher unemployment levels and underemployment.

A key question is how households should behave financially during both an economic boom and a recession.

The reality is that positive economic growth is never permanent. There are always unforeseen events that can quickly alter the fortunes of any nation, resulting in either prosperity or setbacks for households.

Given this economic uncertainty, households should save during boom times so that they can survive during a recession. But, in most cases, households do the opposite — they spend in good times and save in bad times or after an economic recession.

According to economic theory, saving is required for investment to take place, and investment is required to achieve economic growth. Therefore, high savings mean high investment, which results in a high economic growth rate. This means that, for a country to achieve economic growth and development, savings must be reasonably high and sustainable.

Analysing data on households' rate of savings during times of good economic growth and during recessions shows that South African households do not take advantage of an economic boom by increasing their savings. Instead they increase their spending, hoping that the good times will not come to an end.

But some improvements in the rate of savings are realised during or after a recession.

During good times, for example in January 2015, the economic growth rate was 2.5% and personal income tax was between 18% and 40%. But households failed to take advantage of the economic growth and lower personal income tax. Instead of increasing their savings, households increased their spending and the household saving ratio was down to -2.3%.

It appears natural for households to spend more during times of positive economic growth because they become more optimistic about the future.

The South African economy was declared to be in recession during the first quarter of 2017 — a 0.7% dip in GDP was reported between January and

March, which followed a 0.3% decrease in GDP in the last quarter of 2016. It was only after that recession, from the third quarter of 2017, that households turned the situation around and the saving ratio became positive at 0.2%, where it remained in the first quarter of 2018. This positive improvement happened despite a higher top rate of personal income tax of 45%.

Again, the fact that households appear to be more financially disciplined about their spending when the economy is not doing well is shown by the rate of household debt to GDP. In January 2015, when the economy was performing relatively well, the level of household debt to GDP was at 37.2% and this improved to 33.5% in 2017 when the economy was not performing well.

Household economy is detached from the formal economy in several ways such as low usage of banks, savings in terms of assets rather than banks and portfolio arrangement based on physical assets rather than financial assets.

The idea of behavioural economics, which has been getting a lot of attention because it provides insight into savings, could be of assistance in encouraging households to save. Behavioural tools or nudges, which attract attention and modify behaviour in a specific direction, could help to overcome the natural behavioural factors that undermine savings.

A range of policy options could include changing defaults in pension saving, helping households to invest in restricted-access savings vehicles and generally overhauling the way in which saving decisions are framed.

The financial behaviour of South African households calls for consumers' financial and investment education by the National Credit Regulator and the government at large; substituting access to credit with instruments that stimulate savings; devising and implementing incentives to save; and accelerating growth in productivity and incomes by fostering investment in productive assets, otherwise households will continue to increase their spending instead of increasing their savings during times of economic boom.

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