

Significance of Saving Paradigm for Underdeveloped Countries With Reference to Pakistan

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ABSTRACT

Over the last three decades, saving rates have fallen sharply in many industrial countries contributing to the emergence of large current account imbalances in these countries. The developing countries have not only experienced a decline in saving rates but have also witnessed a large and increasing divergence in their saving rates. For example, saving rates have doubled in East Asia, stagnated in Latin America and South Asia, and collapsed in sub-Saharan Africa. The divergence in saving rates has also impacted on the growth performance of these regions; regions with higher saving rates have experienced higher growth rates. It is generally, observed that low saving rates are associated with increased vulnerability to macroeconomic crisis. A country like Pakistan with a low or declining saving rate may occasionally be forced to run large current account deficits to maintain reasonable levels of investment. Pakistan should, therefore seek to achieve a saving rate that is broadly in line with its investment needs. This piece of research is based on identifying the importance of savings for the well being of an economy in particular and that of a common man in general.

1. INTRODUCTION

How much individuals save is affected by their preferences for future over present consumption and their expectations of future income. Individual saving may be measured by estimating disposable income and subtracting current consumption expenditures.

In developing countries, lack of adequate domestic savings is a common problem. To overcome this problem, foreign savings via unrestricted capital flows are encouraged. The issue of low levels of domestic savings is a major problem in small developing states because of high unemployment, low wages, and the engagement of a large proportion of the population in the informal sector and poor performance of the economy. As a short-term solution to the lack of savings by the households, governments of developing countries are embarking on micro financing schemes to enable the households to venture into small business activities.

In a country like Pakistan, the major problem is not only a low level of per capita income but the way in which it is utilized. A consumption-oriented ideology is causing the economic situation to worsen. Other reasons why personal savings are low include the low return on savings, availability of credit schemes that impel to consume more than to save, and a certain social security culturally available due to large families

The saving concept has always been awarded a significant position in the classical teachings of religions. Islam presents a complete package of the Islamic Economic System about income distribution, consumption, saving and charity in the Holy Quran. Major emphasis is laid on always spending less than the available resources. It does not recognize the pure materialistic bent of excessive consumption. Limited consumption and charity are the components on which major emphasis is put in Islamic economic behavior.

The teachings of Christ tell us about the virtues of saving and contented behavior not only for one's own household but in the

form of charity which may be helpful for neighbors and the society.

A strong concept of saving started in the Vaishya (the traders) caste group, who being traders started lending money on interest. Locally they were known as Baniya and are considered as pioneers in introducing new ways of saving in cash and kind.

2. LITERATURE REVIEW

Zaidi Hasnain (2007) has mentioned that investment depends on several factors including savings, costs, revenues and future expectations. The most important factor underlying investment is savings. In case of developing countries, investment falls below the desired level, mainly because of low savings. Though a necessary condition for investment, savings in themselves are not enough to induce investment.

Behram Tariq (2006) has mentioned that it is obvious that domestic savings constitute the backbone in capital formation and therefore play a significant role in the economic growth of any developing country. Apart from this, it also helps control inflation and increase investment and employment. It enables the common man with average income to participate in the economic advancement of the country and also reduces and ultimately eliminates dependence on foreign aid and loans and makes the economy self-reliant and self-supporting.

Karim Abdul (2006) has pointed out that the crucial importance of saving and investment for sustainable economic growth is universally recognized. A developing country in its very early stage has low income and domestic saving constraint. This can be eased by external resources supplementing domestic resources.

Basher Javed (2002) has described that in a country where there is hardly any social security, returns on savings constitute an important instrument for meeting the basic socio-economic needs. Most people lack the skill and entrepreneurship to invest in risk-carrying ventures and run them successfully. The recession has

greatly reduced the purchasing power of the people and is creating acute dissatisfaction among the masses. If the amount deposited in savings schemes went to the government exchequer and was not used for further generation of capital, it was not the fault of the small saver.

Goldstein and Barro (1999) have analyzed that the majority of countries in West Africa benefit from monetary stability and a long history of savings mobilization. With recent innovations in older cooperative networks and new approaches to lending operations, new financial institution can reach the different social categories, including those of very limited income. Refinancing by the banking sector or external funds occurs under contract without the institution being subjected to the norms imposed by those who have the money.

3. INTERNATIONAL PERSPECTIVE OF SAVING

Savings provide the most important economic link between the past, present and future of a country. The stock of savings of a nation sets a limit on the level of its gross investment and its growth rate. Global saving grew in 2005 to 22% of GDP. This is about 11.52 percentage points higher than at the cyclical trough in 2002 and comparable to the average for the 1990s. Higher saving in the emerging economies continued to drive the recent increase. Oil-exporting emerging economies accounted for a growing share of global saving in 2005; their saving rates rose by 4 percentage points. The mature, rich and industrialized societies with near full employment level of income are likely to follow the life-cycle pattern of consumption and savings

In India demographic variables like life expectancy, literacy rate and dependency ratios have emerged as key determinants of savings in addition to traditional variables like real interest rate, growth, per capita income, spread of banking facility and rate of inflation. China's high saving and investment is due to usually high enterprise and government saving.

Moreover, enterprise saving in particular has increased significantly over the last 10 years. The special features of China, high enterprise and government saving, are largely the result of policies particular.

High aggregate savings rate in China is primarily driven by corporate savings. The high level of enterprise saving required to finance high levels of investment has been facilitated by a low-dividend policy. In the extreme case of many state-owned enterprises, there are no dividends at all. In some cases, the reluctance to distribute profits reflects uncertainty about ownership structures and the weak state of corporate governance.

4. THE SAVING PATTERNS IN PAKISTAN

In a country like Pakistan, the major problem is not only a low level of per capita income but the way in which it is utilized. A consumption-oriented ideology is causing the economic situation to worsen. With majority of country's population getting a disproportionately low share of national income, their ability to save will be low and so will be their contribution to national savings.

Other reasons why personal savings are low include the low return on savings, availability of credit schemes that impel to consume more than to save, and a certain social security culturally available due to large families. The government of Pakistan has been launching many schemes to increase the overall rate of saving in the country but due to low incomes, Government savings are low for as long as tax payment and collection remain weak and expenditures not managed judiciously.

Hence, in the short and medium run, if Pakistan wants to sustain its growth and increase its investment without paying increasing shares of income in interest or dividends, it has to finance this investment by raising its domestic saving rate. Our savings potential is low, it must be appreciated that total national savings are composed of individual personal savings, business savings (corporate savings), and government savings.

Table - 1
Composition of Saving in Pakistan
 (% of GDP)

	2001	2002	2003	2004	2005	2006
National Saving	15.8	16.5	18.6	20.8	18.7	15.1
Public Saving	-0.1	1.6	1.8	1.7	3.7	2.6
General Government	-0.9	-0.1	0.2	0	1.6	0.9
Others	0.8	1.7	1.6	1.7	2.1	1.7
Private Saving	15.9	14.9	16.8	19.1	15	12.5
Household Saving	14	13.1	14.8	16.8	13.2	10.8
Corporate saving	1.9	1.8	2	2.3	1.8	1.6
Domestic Saving	17.1	17.8	18.1	17.6	16.4	13.2

Source: State Bank of Pakistan- Semi Annual report- 2006.

The situation of national savings informed by the state bank of Pakistan is that national savings rose sharply by 16.5 percent during FY06 compared to the 7.5 percent growth in the preceding year, nonetheless this increase is lower than the rise in nominal GDP. As a result, the national savings to GDP ratio dropped slightly (by 0.1 percentage points) to 16.4 percent during FY06, the lowest level since FY01.

Although national savings rose sharply by 16.5 percent during FY06 compared with 7.5 percent growth in the preceding year, nonetheless this increase is lower than the rise in nominal GDP. As a result, national savings to GDP ratio slightly dropped by 0.1 percentage points to 16.4 percent of GDP during FY06, the lowest level of national savings since FY01.

In fact, despite rising interest rates, national savings to GDP ratio did not improve mainly due to (1) prevailing negative real returns on deposits being offered by the banks (2) rise in NSS rates was not in line with the expectations, (3) continued ban on institutional investment in NSS (which has been relaxed recently during FY07), and (4) continued consumption boom in the economy. In particular, the strength of aggregate demand supported by both an expansionary fiscal policy as well as rising private consumption in recent years deteriorated the savings rate in the economy.

5. SAVING OF PAKISTAN IN COMPARISON WITH ASIAN COUNTRIES

Historical data for Pakistan place the national saving rate at around 14 percent of GDP on average for the period 1973-2005 and the domestic saving at 11 percent of output on average for the same period. While the national saving rate has been at comparable levels to the one in some of the fast growing East Asian economies, the domestic saving rate for Pakistan has been significantly lower.

6. THE FORMAL AND INFORMAL SAVING MODES IN PAKISTAN

The financial sector of Pakistan is composed of a variety of formal and informal organizations:

1. The central bank 'State Bank of Pakistan', which issues the currency and supervises other financial organizations
2. Money transfer intermediaries such as commercial banks
3. Organizations which work closer to the public primarily by accepting deposits such as postal saving services, private finance corporations and saving centers working under a 'Central Directorate of National Savings (CDNS)'
4. Specialized banks which directly serve the public primarily by issuing loans in the agricultural sector, i.e., the 'Agricultural Development Bank of Pakistan.

5. Informal self-administered saving groups such as 'Rotatory Saving and Credit Organizations' (RoSCAs).

7. THE COMPARISON BETWEEN FORMAL AND INFORMAL SAVING MECHANISMS IN PAKISTAN

Informal finance mechanisms are quite prevalent in low income countries and are successful in meeting some specific financial needs. The advantage of informal mechanisms such as RoSCAs is the ability to overcome some of the information and enforcement problems that often lead to the absence of formal markets. Because savings groups tend to be localized, agents on both sides of transactions often know each other personally. Therefore, informational problems such as adverse selection, moral hazard, monitoring, and verification are less serious.

However, the fact those institutions tend to be localized means they are less able to exploit scale economies and are more vulnerable to local economic shocks affecting all group members. The formal sector is superior on these grounds, and provides some additional advantages over the informal sector, both for the individual and the economy.

The access to formal institutions depends on physical access (having a branch nearby). This typically means that rural households are at a disadvantage, as the distance to a formal institution branch can be great, and can involve substantial transportation costs. There are no explicit restrictions on participation for any groups, physical distance and travel can provide barriers to participation by women in particular, since the observance of *Pardah* restricts movement outside of the household. And quite aside from physical access, participation in the banking sector also depends on education; in order to open and operate an account, basic skills such as reading, writing and keeping track of the account are necessary. The literacy rate is just 40% in Pakistan, which limits the participation of a substantial number of men and women.

Unlike formal, the informal institutions are typically located locally and do not involve substantial travel. Further, some groups consist exclusively of women; combined with reduced travel, this means that women have greater access to informal institutions. And finally, unlike formal, the functioning of the informal group does not require literacy or numeracy of all the members.

8. RESEARCH METHODOLOGY

To present in depth analysis on the pattern of savings in Pakistan – rural versus urban modes will be considered by surveying technique (questionnaire), I have used survey forms as the primary sources of information. Furthermore, sufficient data is collected from the internet and other sources such as newspapers and articles from magazines.

8.1 Empirical Results and Analyses

To address the grave problem of maintaining rate of saving and finding out possible solutions, we have conducted a survey (through questionnaires and structured interviews) among the rural-urban population. The key findings are given below:

1. Contrary to the general belief that higher education group saves higher; we have found entirely opposite in the case of Sindh. In comparison to Punjab, household with little or no education save the most and their saving rate varies from 50 to 55 percent. As the level of education of the head of the household increases the saving rate declines.
2. Who saves more? It is the skilled agriculture workers who save more on average, between 25 to 27 percent. This is why rural saving is much higher than the urban savings.
3. The head of the household who is self-employed has the highest saving rates, ranging from 28 to 31 percent. Those heads of the households involved in farm activities save the most, ranging from 33 to 35 percent. The households head

involved in non-farm sector, their saving rates are lower than the average overall saving rate of the country.

4. According to the results of conducted survey, 51 percent head of the households are in the age group of 25-45 years and remaining in the age group of 25-60 years. The heads of the households belonging to the age group of 55-60 years save the highest- their average savings are 52 percent higher than the over all average savings.

9. CONCLUSIONS AND RECOMMENDATIONS

The issue of low levels of domestic savings is a major problem in small developing states because of high unemployment, low wages, and the engagement of a large proportion of the population in the informal sector and poor performance of the economy.

Importance of savings cannot be over - emphasized for reasons ranging from personal to national with the increasing elderly population in the absence with the increasing elderly population in the absence of any state planned social security system its significance is heightened even more.

Savings depend on several factors such as interest rates, inflation, the consumption habits of the people, and taxes. Higher interest rates, for instance, encourage savings. The household saving of India is higher in the region due to its banks (particularly public sector banks) which continue to be the primary mobilisers of domestic financial savings (in addition to Provident Funds, Small Saving Schemes, and Life Insurance Corporation). The corporate saving in China is higher in the region because high aggregate savings rate in China is primarily driven by corporate savings. The high level of enterprise saving required to finance high levels of investment has been facilitated by a low-dividend policy. In the extreme case of many state-owned enterprises, there are no dividends at all. In some cases, the reluctance to distribute profits reflects uncertainty about ownership structures and the weak state of corporate governance. The government of Pakistan

should analyze the saving patterns of India and China and implement the policies necessary to increase the saving in the country.

Pakistani society's high propensity to consume, predominance of cash economy, people's reluctance to declare money, lack of access to banking services and lack of resources and saving habits are some of factors responsible for low saving rate. The household savings would be promoted by motivating the masses to change their spending habits and through provision of incentives to save. The people have to be educated to keep their spending within affordable means at ceremonies such as marriages, funerals etc and to guide them to reduce the number of costly functions by making them simple and cheaper. There is also a need to educate the people to live within their means. Controlling the wasteful expenditure in the public sector would also impact positively on the household savings.

Pakistan is capital deficient country having unequal distribution of wealth. The rich class has very high consumption on luxurious items and hence tending low saving while the poor class on account of poverty cannot save. Government should take steps to increase the income of the common people in accordance with the increasing inflation because increase in the inflation decreases the saving ability of the people.

We should do away with conspicuous consumption and increase our domestic savings rate so that we can reduce our dependence on foreign borrowing. Paying our due share of taxes to the government would lower our fiscal deficit, provide sufficient room for development spending and do away with the need to borrow. Household savings and corporate savings along with public sector savings should move us in the desired direction.

The Informal saving mechanism in Pakistan is more practiced as compared to formal saving mechanism due to easy accessibility, no education requirement and formation by the group of the people who know each other well. The government should take initiatives to introduce the new instruments and also make the instruments more understandable generally to common people and

specifically illiterate people. Better access to savings facilities and availability of suitable savings instruments seem necessary for stimulating rural savings. Improvements in rural transportation would probably have a higher impact on the coverage of savings facilities than any other measure, but greater use of mobile units could help a great deal.

10. FUTURE DIRECTION FOR RESEARCH

This study is quite elaborative in nature. It provides base for extensions in research in this area. Further studies that can be done on this topic include exploring the cultural and social aspects of savings. Further more, the savings instruments which are currently circulating in the markets are of very restrictive nature so there is a dire need to conduct research in this aspect and issue those instruments which satisfy the demand of people from diverse cultures.

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