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Why we need savings

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Savings are needed to support aging populations and to provide for investment which would boost economic growth. The question is how government can intervene to improve the savings rate.

As developed and emerging economies start to recover from the financial crisis, they need to strongly consider the importance of encouraging a culture of savings.

Aging populations put strain on government funds

Promoting a higher savings rate has become an economic priority in European countries with aging populations. Europe's ratio of working people to the retired population (the *dependency ratio*) is approximately 5 to 1. In a few decades, this ratio will fall to around 2 to 1. If pensioners are to be supported by social grants only, two people would be working to support one pensioner. This is clearly unsustainable.

Saving for national growth

High levels of national savings reduce a country's reliance on and exposure to the unpredictable global capital market. In South Africa, unfortunately, the savings levels are very low, which makes the country dependent on foreign investment to finance its growth. Such dependency is not healthy - foreign investors often withdraw during troubled times.

For individuals, curbing excessive consumption and providing for one's future well-being is necessary for maintaining and improving one's quality of life, as well as for relieving the government of the burden of funding one's old age. South African policymakers, realising that the level of personal savings is far too low, are investigating ways to encourage savings and temper excessive levels of consumption.

How governments can boost individual savings

While the importance of savings is broadly accepted, it's debatable whether or not governments should get involved in encouraging savings. Given that most people do not save sufficiently, governments probably should intervene to some extent. This raises a serious question: how?

There are various approaches that could be adopted:

Compulsory savings scheme

Singapore's Central Provident Fund started in 1955 as a compulsory 'save-as-you-go' savings scheme. Each month, a portion of a worker's income is automatically placed in a savings account that can only be touched after retirement. Adjustments were made to the fund as the country developed: for example, in 1968 workers could purchase flats with their savings.

From 1987 onward, as Singapore's life expectancy increased, the government required citizens to set aside a minimum sum beginning at age 55 which would provide them with a monthly income on retirement.

Singapore highlights the importance of savings and the way that developing nations, with the right intentions and proactive government involvement, can promote GDP growth.

Tax credits

A tax credit could be made available to lower-income individuals and households that contribute to a qualified retirement savings plan. This should include employer-sponsored plans or government plans. The amount of the credit would depend on the gross income of the individual or household and the size of the contribution that is made.

Catch-22

For these models to work in South Africa, our national employment numbers would have to improve dramatically. 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. Yet in order to create jobs, we need more investment funded through savings.

10% is all it takes

Assume that people save 10% of their income annually and that they receive an annual salary increase of 5%; in forty years they will have saved almost 13 times their annual income.

It is estimated that most retirees need approximately 80% of their annual income to fund their lifestyle, meaning savings need to be equivalent to almost 16 years of a retiree's annual income (which is equal to 13 times the working annual salary). Assuming an average life expectancy of 80, this level of saving will serve most people quite well for many years.