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Uwe Corsepius, Kiel*

Savings Mobilisation in Developing Countries

Stagnating development aid and continued reluctance on the part of western commercial banks to grant new loans to problem debtor countries have led many developing countries to pay greater attention to the mobilisation of their own resources. This article outlines a strategy for increasing the extent to which domestic savings are made available for development financing.

In economies where the division of labour is already fairly advanced, a functioning financial market has an important part to play in mobilising and allocating domestic savings. It is more efficient to involve financial institutions in the financing of investment than to leave savers and investors to reconcile their interests themselves. The financial institutions can exploit economies of scale in the collection of information and the spreading of risks; there are also macroeconomic benefits to be gained from their ability to carry out maturity transformation between savings and lending and to channel funds from surplus to deficit regions.

A high proportion of total domestic savings must go into savings deposits if the macroeconomic efficiency gains from financial intermediation are to be realised. The part that savings deposits play in financing development then depends on the efficiency of the financial institutions. Hence, as well as mobilising financial savings, it must be ensured that the financial system's consumption of resources is minimised and that deposits are used to satisfy the credit demand of those investors whose projects promise the highest macroeconomic return.

Depositing money with financial institutions is only one of the ways in which savers in developing countries can invest their savings; the purchase of real assets such as real estate and precious metals, the hoarding of cash and investments in the informal financial sector are important alternative forms of saving. The composition of total savings and hence the level of savings deposits

depend primarily on the relative yields and risks on the various forms of investment, so that the effective real deposit rates paid by financial institutions are crucially important for the mobilisation of financial savings. Multiple regression estimates for many developing countries confirm that there is a significant positive correlation between the level of real deposit rates and the volume of financial savings.¹ Nevertheless, in the eighties the authorities in many developing countries continued to set such a low limit on the nominal interest rate for savings deposits that the banks were unable to compensate savers for the loss due to inflation (see Table 1). Moreover, interest rate ceilings are rarely adjusted to fluctuating inflation rates, with the result that real interest rates fluctuate with inflation. With high and variable inflation rates, the real return on financial assets is therefore not only negative but also difficult to predict in the short term.

As a result of these policies, financial savings in these countries are low (see Table 1) and informal financial markets have sprung up in which government regulations are circumvented. Since the informal financial sector consists of a host of unrelated local sub-markets, there is no interregional balancing out of savers and investors. Informal credit markets can therefore not replace a networked banking sector, since there is no means of ensuring that the investment projects that are efficient in macroeconomic terms will be financed. In addition, the illegality of informal

¹ See U. Corsepius, B. Fischer: Interest Rate Policies and Domestic Savings Mobilization: A Survey of the Empirical Evidence of Asian Countries, in: Asian Economies, No. 62, September 1987, pp. 45-64.

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financial markets and the impossibility of taking legal steps against defaulting debtors means that informal lending rates include a substantial risk premium and are higher than they would be in a liberalised formal financial sector. In some cases, the high informal lending rates only reflect the monopoly position of the lender.

In view of this, a number of authors have proposed raising nominal interest rates on savings deposits or abolishing the limits.² Viewed in terms of "loanable funds", however, it becomes clear that higher nominal interest rates alone will not necessarily lead to an increase in the volume of total loanable funds. Loanable resources increase if savers convert real assets into now more attractive financial assets, but if they move savings from the informal to the formal financial market, total funds for financing loans decrease;³ savings lent via the informal sector are available in full to enterprises, whereas banks cannot expand the supply of credit by the full amount of the increase in deposits since compulsory minimum reserves must be held. Successful interest rate reform must therefore aim to induce savers to create savings deposits by liquidating real assets.

² See for example International Monetary Fund: Interest Rate Policies in Developing Countries, Occasional Paper No. 22, Washington 1983; J. B. Moore, A. H. M. V. Chowdhury: Domestic Savings in Selected Asian Countries, Asian Development Bank, Economic Staff Paper, No. 2, Manila 1981.

³ S. Wijnbergen: Interest Rate Management in Developing Countries: Theory and Simulation Results for Korea, World Bank Staff Working Papers, No. 593, Washington 1983.

⁴ Cf. M. G. Bradley, J. W. Graham: Inflation Risk and Consumer Portfolio Behaviour, in: Quarterly Review of Economics and Business, Vol. 26, 1986, No. 1, pp. 88-94.

⁵ Cf. V. Galbis: Financial Sector Liberalization under Oligopolistic Conditions and a Bank Holding Company Structure, in: Savings and Development, Vol. 10, 1986, No. 2, pp. 117-140.

This cannot be achieved simply by raising nominal interest rates on deposits. Steps must also be taken to reduce the inflation risk, which affects the real return on financial assets but not the utility of durable consumer goods.⁴ If that is not done, risk-conscious savers will prefer to invest in physical goods despite higher real interest rates on financial assets. The inflation risk can be attenuated or eliminated either by curbing inflation or by indexing nominal interest rates, although curbing inflation is the better method, bearing in mind that the mobilised deposits are ultimately to finance fixed investments that are efficient in macroeconomic terms. Only a monetary stabilisation policy can prevent the uncertainty caused by high and variable rates of inflation from prompting firms to postpone long-term investment and to use their funds instead for inflation hedges or short-term speculative investments.

As to the implementation of an increase in real interest rates, it should be remembered that the formal financial markets in many developing countries are oligopolistic and that, in addition, there are often close capital links between financial institutions and industrial firms.⁵ The holding companies maximise group profits and usually have no interest in using the scope provided by lower inflation to raise real interest rates on savings deposits. Higher deposit rates mean higher capital costs for the companies and hence a transfer of resources from the group to the previously disadvantaged savers. Measures to demerge conglomerates are a conceivable way of achieving an increase in real deposit rates. In addition, deregulation that facilitates market access for both domestic and foreign banks may increase competition for deposits and force the existing system to raise real deposit rates. Such reform would have to be accompanied by stricter banking supervision to prevent new competitors from being taken over by existing

Table 1
Real Interest Rates, Inflation Rates and Financial Saving in Selected Developing Countries, 1970-85
(percentages)

Country	Period	Deposit rate	Lending rate	Inflation rate	Financial saving/GDP ¹
Bangladesh	1971-85	- 7.4	- 5.1	18.5	12.2 ^a
Kenya	1970-85	- 4.3	- 1.2	12.0	13.9 ^b
Nigeria	1970-85	- 9.7	- 7.0	16.5	10.8 ^c
Pakistan	1970-84	- 1.7	0.2	10.7	13.7
Peru	1970-85	- 18.2	- 4.7	56.0	15.4 ^b
South Korea	1971-85	- 1.1	2.6	12.1	24.4 ^c
Thailand	1970-85	1.7	7.9	7.8	32.9

¹ Savings and time deposits, including foreign currency deposits, as a percentage of gross domestic product. —^a 1974-85. —^b 1970-84. —^c 1971-84. Sources: Banco Central de Reserva del Perú, Memoria, various issues; International Monetary Fund: International Financial Statistics Yearbook, Washington 1986; World Bank: *World Development Report* 1987, Washington 1987.

institutions and to safeguard the stability of the financial system. Finally, temporary minimum reserve ratios on savings deposits are a further possible means of raising real interest rates in the formal financial system.

Form of Savings Instruments

The attraction financial assets hold for savers depends not only on the real return and the inflation risk they carry but also on the extent to which savings instruments are fashioned to take account of the population's savings motives. Analysis of the self-help organisations in the informal financial sector of many developing countries gives an idea of the possible improvements that can be made. Here savers can arrange their savings activity according to their own objectives without regard to government regulations.

With the widespread rotating savings associations, each member deposits a previously determined sum at each meeting held at regular intervals.⁶ The total contributions from the meeting are then placed at the disposal of one of the members. The order in which members receive a pay-out is decided at the outset by mutual agreement, by lottery or by auction.⁷ The attraction of the savings club to members lies mainly in the link between saving and access to credit (see Table 2). According to his place in the order of allocation, the participant receives his past savings plus a loan, which may be substantial and which he repays through

his subsequent contributions. In the formal financial sector, by contrast, deposit-taking and lending business are usually separate. This is particularly clear in the case of the post office savings banks commonly found in rural areas, which only accept deposits and channel their funds to the public sector. One way in which the financial institutions could couple deposit-taking and lending would be to offer building loan contracts. Not only do these give savers greater motivation, but in the course of the deposit-taking business the banks would gather information on savers' creditworthiness that would not have to be collected again when the time came to grant the loan.

A comparison of informal savings groups with the savings accounts offered by financial institutions reveals that the savings clubs manage with a minimum of regulations and are very flexible as regards both the level of individual saving and the interval between payments of contributions, whereas in the formal financial sector minimum deposit rules, long fixed periods of investment and time-consuming and complicated formalities often deter small savers from opening a savings account with a bank. In rural areas in

⁶ On the prevalence and operation of savings associations in Africa, see M. P. Miracle, D. S. Miracle, L. Cohen: Informal Savings Mobilization in Africa, in: *Economic Development and Cultural Change*, Vol. 28, 1980, No. 4, pp. 701-724.

⁷ In some savings clubs an additional fund is established from which loans are made to members.

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Alexander Brunckhorst

INTERNATIONALE FINANZMÄRKTE UND DIE VERSCHULDUNG VON ENTWICKLUNGSLÄNDERN

Der Beitrag der internationalen Finanzmärkte im Rahmen alternativer Ansätze zur Bewältigung der Verschuldungsproblematik von Entwicklungsländern

(INTERNATIONAL FINANCIAL MARKETS AND THE DEBTS OF DEVELOPING COUNTRIES)

(The Contribution of the International Financial Markets within the Framework of Alternative Approaches to Overcoming the Debt Problems of Developing Countries)

Not only businessmen, academics and politicians are presently concerned with the indebtedness of the developing countries. The increasingly pressing debt service bills and the belief that important debtors are about to become bankrupt lead repeatedly to headlines in the daily press, making the importance of this problem clear to a broader public. This study by Alexander Brunckhorst is a doctoral thesis written at the chair of Professor Dr. Jens Lübbert, University of Hamburg. It is concerned with the potential contribution of the international financial markets to overcoming the critical debt situation of developing countries. (In German)

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particular, the attraction of particular forms of saving also depends on whether they make allowance for the sharp seasonal fluctuations in farmers' incomes and liquidity requirements. Studies of savings motives also provide evidence of the great importance attached to flexible forms of saving in developing countries. Many savers give provision for emergencies as an important reason,⁸ a function that can be performed only by a savings instrument that can be realised quickly in an emergency. These considerations mean that the banks must intensify their market research as a basis for developing savings instruments geared to meet the needs of particular target groups. Experience in India with the Pigmy Deposit Scheme has shown that savers are prepared to accept a relatively low interest rate in return for low transaction costs and access to credit.⁹

Institutional Policy

The density and structure of the financial institutions' branch network is another determinant of the level of financial saving in developing countries. In rural areas in particular, long distances from the bank increase the cost for savers to deposit money and therefore encourage them to invest their savings in physical assets or to hoard cash. Multiple regression analyses confirm that there is a significant positive correlation between the number of commercial bank branches and the volume of deposits.¹⁰

Table 2
Reasons for Participation in Savings Clubs in
Nigeria, Thailand and Zimbabwe
(percentages)

Reasons	Nigeria	Thailand	Zimbabwe ^a
Social reasons^b	29.7	18.5	38.0
Limitations of formal financial sector	56.1	77.6	37.0
– Lower costs/higher returns	–	20.6	7.0
– Saving of small amounts	–	–	30.0
– Quick access to loans/ source of contingency funds	40.1	44.7	–
– Other ^c	16.0	12.3	–
Other^d	14.2	3.9	25.0
Total	100.0	100.0	100.0

^a Total includes multiple answers. ^b Asked by others, savings discipline, learning from each other, working together. ^c Inconveniences, no confidence. ^d Bulk ordering, security, group support.

Sources: D. Radke et al.: Mobilization of Personal Savings in Zimbabwe through Financial Development, German Development Institute, Berlin 1986; H. D. Seibel: Ansatzmöglichkeiten für die Mobilisierung von Sparkapital zur Entwicklungsfinanzierung, Forschungsberichte des Bundesministeriums für Wirtschaftliche Zusammenarbeit, No. 63, Cologne 1984; D. Vongpradhip: Urban Unorganized Money Markets in Thailand, Bank of Thailand Discussion Papers, No. 41, Bangkok 1986; own calculations.

In many developing countries the commercial banks mobilise between 75 and 90 % of all deposits; since they concentrate on urban centres,¹¹ it is tempting to diagnose underprovision in rural areas and to call for an expansion of their branch networks. However, this would be to overlook the fact that there are a number of other institutions in rural areas that also offer financial services but account for only a small proportion of total deposits. The post office savings banks, savings banks, development banks and co-operatives can be named in this regard. If private banks were forced by law to extend their branch networks into rural areas against their will, the financial system could quickly become overinflated. The additional deposits would then not offset the cost of the new branches, so that either public subsidies would be needed or savers and borrowers would have to bear the cost in the form of wider spreads between deposit and lending rates. The cost of expanding the financial sector could therefore far outweigh the gains in macroeconomic efficiency.

Reform of existing financial institutions to increase their savings mobilisation capacity seems more promising. Their access to low-cost refinancing at the central bank and to subsidised credit may be regarded as serious stumbling-blocks. If development banks and co-operatives see themselves merely as loan distribution agencies and are under no compulsion actively to seek deposits, the low level of their deposits is understandable. Reform should therefore expose these institutions to stronger competition with the commercial banks for deposits and might, for example, link subsidies to the level of resources mobilised.

Competition for deposits is further hampered by the fact that governments' selective credit policies seriously fragment the financial markets in developing countries, which are relatively small in any case. In many cases various kinds of special institutions have been founded to favour particular borrowers, such as a particular

⁸ See for example M. H. Agabin: Rural Savings Mobilization in the Philippines, in: APRACA (ed.): Mobilization of Rural Savings in Selected Countries in Asia and Pacific, Bangkok 1985, pp. 326-367.

⁹ Under the Pigmy Deposit Scheme, agents of the syndicate bank collect small savings deposits from households daily or weekly. Interest was initially 3%, but has been 6% since 1971. Cf. N. K. Thingalaya: Mobilizing Small Savings in India, in: Development Digest, Vol. 17, 1979, No. 2, pp. 24-34.

¹⁰ See for example H. P. Bürkner: Savings Behaviour and Savings Mobilization in Developing Countries: A Comparative Analysis of the Philippines and Thailand, Sozialwissenschaftliche Studien, Vol. 15, Bochum 1981, p. 169.

¹¹ Cf. Fischer et al.: Sparkapitalmobilisierung in Entwicklungsländern: Engpässe und Reformansätze, Forschungsberichte des Bundesministeriums für Wirtschaftliche Zusammenarbeit, No. 78, Cologne 1986, pp. 92-94.

industry. They usually have a monopoly within their narrow field of business. In view of the importance that coupling deposit-taking and credit business has for savings mobilisation, the special institutions will at best be able to attract additional deposits in their own specialist sphere of business. Increased competition among the institutions calls for reform in the direction of a universal banking system and hence a unification of the financial market.

Complementary Measures

With a view to mobilising longer-term funds, reform of the financial sector should also include measures to stimulate the stock exchanges, which are still fairly insignificant in many developing countries.¹² On the demand side a further expansion is often hampered by the high costs associated with the purchase of listed securities. Moreover, the narrowness of markets leads to extreme fluctuations in yields and the rudimentary nature of the financial information system makes it very difficult for private investors to assess the standing of individual companies. Investment funds, which reduce the risk and cost for small investors, could ease the problem. Demand could also be increased by allowing easier stock exchange access for domestic and foreign institutional investors, such as insurance companies and banks. On the supply side, listing requirements should take account of the unfamiliarity of many enterprises with shares and not deter them by demanding excessively high standards. The common fear among the owners of family firms that they will lose control if they issue shares can be overcome by introducing non-voting shares. The public sector can also increase the supply of securities, for example by introducing bonds of public-sector enterprises to stock exchange listing. Stimulation of the share and bond markets should, however, be accompanied by an improvement in supervision in order to limit or prevent speculative booms and crashes and to improve investor confidence in the market.

Despite the paucity of reliable statistics, it may be assumed that a substantial part of the domestic savings of many developing countries is invested abroad via capital flight and is not available to finance domestic development. Insofar as capital flight is the consequence of yield considerations, interest rate reform and a reduction in the inflation rate will help

create conditions essential to the repatriation of flight capital. In addition, exchange rates must be adjusted to take account of differences between inflation rates at home and abroad to prevent investors taking refuge in foreign financial assets owing to the danger of devaluation. However, a substantial part of capital flight will be due to political factors, such as fear of the overthrow of the government or expected nationalisation. Attracting these funds back will require further development measures that strengthen savers' confidence in stable economic development.

Conclusions

In many developing countries, reform of the financial environment is essential if savings are to be mobilised. It should be the function of monetary and credit policy to create a stable framework for financial transactions by economic agents and to give savers and investors a more certain basis for decision-making by maintaining the value of money. So that it also leads to a repatriation of flight capital, reform of the financial market should be part of a consistent economic policy oriented towards stability.

An important aspect of liberalisation consists of measures to intensify competition for additional deposits among financial intermediaries and thus help exploit the financial institutions' existing network better and introduce financial innovations. The basis for keener competition are deregulation of the credit institutions in the direction of an universal banking system, and a reduction in subsidised refinancing at the central bank. As a complementary measure to mobilise longer-term savings, the share and bond markets should be stimulated by establishing share-based investment funds and easing listing requirements.

Within this changed environment, the financial institutions' ability to mobilise savings can be enhanced by tailoring savings instruments more closely to savers' needs by means of market research. An analysis of informal savings activities shows the importance of coupling deposit-taking and lending business and having flexible savings instruments that can be realised or used as collateral at short notice in an emergency.

Even if financial savings represent a larger proportion of total domestic savings they will only contribute towards financing development if it can be ensured that the investments financed are efficient in macroeconomic terms. This means amongst other things that the credit institutions must be able to vary interest rates to reflect the different yield and risk combinations of the projects in question.

¹² A survey of share and bond markets in developing countries is to be found in United Nations Secretariat: *Development of Stock Exchanges in Developing Countries*, in: United Nations: *Savings for Development, Report on the Second International Symposium on the Mobilization of Personal Savings in Developing Countries*, New York 1984, pp. 21-35.