SAVINGS MOBILIZATION IN RURAL AREAS LESSONS : FROM EXPERIENCE[1]

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Two myths or assumptions led to neglect of mobilization of savings in the rural areas. These myths seem to dissipate with time. The first myth is the assumption of pervasive rural undersavings; the second is the assumption that demand for financial savings instruments is low. A large amount of empirical evidence from Asian, Latin American and some African countries suggest that the rigid notion of low or zero savings capacity of poor rural households does not hold true. This paper looks at the old approach of rural finance, arguments for and against rural savings mobilization, bottlenecks and conditions for effective savings mobilization in rural areas.

BESPARINGSMOBILISERING IN LANDELIKE GEBIEDE : LESSE UIT ONDERVINDING

Twee mites of aannames het gelei tot verwaarlosing van besparingsmobilisering in landelike gebiede. Hierdie mites disintegreer skynbaar met die verloop van tyd. Die eerste mite is die aanvaarding van chroniese onderbesparing en die tweede mite is die aanname van 'n klein vraag na finansiële besparingsinstrumente 'n groot hoevelheid empiriese getuienis van Asiatiese, Latyns-Amerikaanse en sommige Afrikalande dui daarop dat die rigiede denkbeeld van lae of zero besparingskapasiteite van arm landelike huishoudings nie geldig is nie. Hierdie referaat bespreek die ou-benadering tot landelike finansiering argumente vir en teen landelike besparings-mobilisering, knelpunte en voorvereistes vir effektiewe besparingsmobilisering in landelike gebiede.

1. Introduction

Rural savings mobilization is essential for the development and sustainability of rural financial markets which, in their turn, are vital for economic development. Donors and policy makers have for long embarked on supply-led credit (extension of credit) while neglecting rural savings mobilization. Research results have in various countries proven this policy to be futile. Much empirical evidence from Asian, Latin American and some African countries suggests that the notion of a low or zero savings capacities of poor rural households does not hold true. Rural households have been shown to have a greater capacity to save than has generally been assumed by policy-makers.

In a study involving 239 rural households in Zambia, it was found that on average, savings constituted over 30% of family income (Adams, 1978). Success in developing rural savings clubs in Zambia, Lesotho, Zimbabwe and Malawi and the mobilization of savings through postal savings, saving banks, and credit savings unions in parts of Africa provide further evidence on rural saving capacities (Adams, 1978). Hofmann (1990) estimated the savings rate of Benin farmers to be above ten percent of income. Coetzee (1988) using survey data calculated a savings propensity of 0,26 in Kangwane, South Africa. Household data from a farm record-keeping project in Taiwan revealed a substantial variability in marginal propensity to save from year to year, but in general the marginal propensity to save appeared to have been quite high (Ong *et al*, 1979).

2. The failure of the supply-led approach

Many, if not most donors and policy-makers have for long regarded the supply of credit to small farmers in less developed countries as an important solution of production related problems. It was believed that it would enable small farmers offset risks of new technologies, to buy improved inputs, increase productivity and generate their own capital. However, this has left many credit programmes and specialized institutions in disarray. Many of these institutions have never become financially viable, and most of this credit was either diverted to other uses or got into the hands of large scale farmers (Graham, 1992). The supply-led (also called the traditional or conventional project view)rest on two main assumptions.

1. Saver-borrower behaviour - it is commonly assumed that the rural poor cannot save and will not respond to incentives to save; most farmers need cheap loans and supervision in order to adopt new technologies and make investments; and loans in kind are used in the form granted.

2. Lender behaviour - it is commonly assumed that informal lenders are exploitative, charge high rates of interest and reap large monopoly profits; the rural poor do not receive formal loans because formal lenders are overly risk averse; nationalized lenders can ignore own profits and losses to service risky customers; and all formal lenders can be induced to follow government regulations in allocating services (Adams & Graham, 1981).

Criteria used to grant credit critically affect the performance of credit programmes. Supply-led criteria typically include (inter alia) needs, demand, easing of credit constraints and overstate the role of credit (Pischke, 1991). These criteria ignore the subtleties of risk and confidence.

The Traditional Credit View also involves five important features:

1. The financial viability of specialized financial institutions have not been regarded as a prime objective (Gonzalez-Vega, 1989). The performance has been

evaluated according to numbers of loans and the speed with which money is disbursed to a targeted clientele, the amount of inputs financed, the rate of technology adoption, and the increase in employment and output. Graham (1992), pointed out that it is naive to assume that a substantial share of targeted credit is not diverted to other uses and to associate increase in output with the increase in credit; increased output has multiple causes (Graham, 1992).

2. All practices and operational procedures are geared towards the interest of the borrower. The interest of the depositor or the institution itself receives little or no attention (Graham, 1992; Gonzalez-Vega, 1989). Such borrower dominated institutions have been characterized by the absence of a clear concept of risk. They have attempted to channel funds to target clientele, for specific purposes, rather than to evaluate the borrowers' repayment capacities and risk.

3. Such credit programmes have mistrusted the market and minimized the role of interest rates as a major instrument of resource allocation (Gonzalez-Vega, 1989). It was thought that interest rates for agriculture should be kept low to promote development and to assist the rural poor (Donald, 1976 ; Adams & Graham, 1981). Interest rates assigned to savings have simultaneously been less than the concessionary rates charged on loans.

4. Such rural finance projects have neglected savings mobilization (Adams & Vogel, 1984; Gonzalez-Vega, 1989).

5. Most supply-led credit programmes and their specialized institutions have not been financially viable because of high overhead costs and low loan recovery. According to Graham (1992), their transaction costs have been greatly underestimated, and they have often collapsed into expensive, one-shot, income-transfer schemes to the non-poor. Both borrowers and savers incur transaction costs, monetary as well as non-monetary, which can be several times the interest paid on loans (Adams & Vogel, 1984). Policies and programmes based on the traditional view have resulted in high delinquency and default rates (Boakye-Dankwa, 1979; Sandertne, 1978), thereby reducing the lending capacities of many financial institutions. The criteria used in these programmes have not necessarily been compatible with the institutions' survival (Gonzalez-Vega, 1989). They also suffered from an inability to produce good loans and accommodate sustainability of intermediaries, were associated with high transaction costs for borrowers and savers, and reduced efficiency by destroying competition for loans (Von Pischke, 1991).

3. Why neglect of savings mobilization?

While policy makers overemphasized the function of subsidized loans in rural development, they neglected or ignored savings for the following reasons:

1. It was assumed that poor rural households cannot or will not save, because of the low income and the high propensity to spend the low income on ceremonial activities, in addition to the basic necessities of life (Adams, 1978; Adams & Vogel, 1984; Fernando, 1991; Meyer, 1989).

2. Subsidization of lending rates was a cornerstone of many programmes (Meyer, 1989). Since low interest rates were set for loans, interest rates on deposits also had to be low, thereby discouraging rural deposits. To certain financial institutions, the cost of rural savings mobilization far outweighed the benefits (Fernando, 1991). Policies of low interest lending are inconsistent with mobilization of savings.

3. It was argued that aggressive mobilization of savings by financial institutions would cause savings simply to be diverted from one institution to another or from rural to urban areas (Wague, 1988).

4. The availability of foreign loans to finance rural developmental activities made it convenient for policy-makers to ignore mobilization of rural savings.

5. Another reason is the widespread use of "forced saving" mobilization methods like agricultural price schemes. Under these schemes rural farmers are required to pay levies during favourable price periods as insurance against bad periods (Fernando, 1991).

4. Arguments for voluntary rural savings mobilization

The most important arguments forwarded by development economists like Fernando (1991), Meyer (1989), and Vogel (1984) for emphasizing savings mobilization include:-

1. Saving mobilization can lead to a more equitable distribution of income by giving the poor access to financial assets with higher returns than those from tangible assets. For this purpose positive real rates of interest and low transaction costs are needed. This will also improve resource allocation, since, a considerable amount of money saved under informal arrangements are either kept idle or spent on low return investments.

2. Savings mobilization enables financial institutions to improve their financial viability and overall performance. Repayment performance may be superior on loans made through mobilized funds for borrowers are more likely to repay promptly when they know that resources come from neighbours rather than from some distant governmental agency or international donor. It also creates customer loyalty and resources for loans. Deposit mobilization therefore contributes to the stabilization of rural financial markets' liquidity and solvency, and reduces their dependency on governments and donors funds (Schrieder & Heidhues, 1991).

3. Savings mobilization is an antidote to asymmetric information and incentive problems; it adds value to the relationship between intermediaries and clients. It helps rural financial institutions to make sound creditworthiness decisions, deposit records provide valuable information on the savings history and solvency of potential borrowers. Empirical evidence shows that debtors are less negligent to honour loan obligations when they hold deposits at the lending institution. This information reduces the risks, and thus the costs of lending.

4. It allows small farmers to improve their credit worthiness through accumulation of financial assets.

Von Pischke (1991) remarks that:

"If half the effort that has been spent on throwing credit at the frontier has been devoted to stimulating voluntary savings mobilization, the financial landscape in much of the Third World would probably be more attractive today".

5. The South African perspective

About forty percent of the people in South Africa live and find their livelihood in the rural areas, with black people constituting about 91 percent of the total population (CSS, 1993). The low incomes of this rural populace caused many to regard the mobilization of savings in those areas as unimportant. However, recent findings by Spio (1994), Seidman (1994) have disputed this view.

5.1 Savings and ethnicity

The differentiation of the South African society into racial and ethnic groups under apartheid. created structural imbalances in the socio-economic fibre of the society, caused the different racial and perhaps also ethnic groups to have different social contexts and access to wealth. At least throughout 1990, low income black households displayed a higher marginal propensity to save than high income white households (Seidman, 1994).

Two sets of explanation have been advanced for these different saving functions (Seidman, 1994). (1) Compared to the white families, black households had little wealth or access to outside resources such as credit and government assistance, and blacks saved more both for security and large purchases. (2) From the mid 1970s, blacks' wages and salaries rose in real terms, while real white income stagnated or declined. Duesenberry (1967) and Friedman (1957) found substantial differences in saving behaviour between black and white communities in United States of America, with whites consuming more and saving less than blacks, even within the same income class. Explanations include that (1) black families live in separate and poorer neighbourhoods and regard lower consumption levels as the norm; (2) they have less wealth of their own and have to save more from current income (Duesenberry, 1967); and (3) black households expect lower incomes in the long-term and therefore, they typically save more and react less rapidly to increases in income (Friedman, 1957).

5.2 Types of savings

Four types of savings are commonly among rural people:

1. Savings in kind, largely in the form of food, cattle and other livestock. Many people with spare cash convert this money into cattle, in most cases partly because of the low deposit rates and the lack of savings facilities (Beuret and Beuret, 1992). In the absence of alternative savings or investment opportunities, cattle or other livestock may be the only readily convertible form of capital, which also serves as a hedge against inflation. Recent droughts have however shown the security value of cattle to be lower than had been assumed (Baker, 1981).

2. Stokvels represent a type of rotating savings and credit associations (ROSCA) (Kelly, 1993); a group of people (neighbours, people working at the same place, members of the same family or members of a church congregation) enter into an agreement to regularly contribute a fixed amount of money to a common pool. Depending on the rules governing the particular stokvel, this money or a portion of it may be drawn by members either in rotation or in time of need. Membership of stokvels is voluntary; honesty and reliability are important requirements (Lukhele, 1990).

   Stokvels educate people in the discipline of saving and in mobilizing and using money for mutual benefit (Lukhele, 1990), although some other stokvels are formed for purposes other than savings mobilization.

3. Unorthodox savings which include, for example the hoarding of money in small boxes in the house, under pillows, buried underground or giving it to someone, normally a older person, for safe keeping.

4. Formal savings, for example savings at the postal savings bank and commercial banks

6. Impediments and conditions for effective savings mobilization

The financial and monetary policies of most developing countries have acted as impediments to savings and need a change (Fischer, 1989). The attractiveness of the reward paid on savings should be increased, together with increased convenience, liquidity and security of savings.

6.1 Regulations and supervision

Reasons advanced by governments to justify regulation of financial markets almost invariably appear reasonable. However, regulation often impedes the emergence of a diversified financial infrastructure and discriminates against savers. High reserve requirements discourage deposit mobilization (Meyer, 1989).

Rediscount facilities constitute another bottleneck. The concessionary interest rates on discount lines are usually lower than the rates that intermediaries would have to pay to mobilize voluntary private savings (Adams & Vogel, 1984). Financial institutions are therefore better off using those facilities than to mobilize rural savings; the cost of rural savings mobilization frequently exceeds the cost of refinancing at central banks.

Credit ceilings again reduce efficiency in the financial sector in two ways. They limit all banks equally, including those most efficient at lending and those with dynamic entrepreneurs as clients. Credit ceilings also reduce efficiency by destroying competition for deposits. Once ceilings are reached, extra deposits represent idle cash reserves. Banks stop efforts to attract deposits and to provide good services to existing depositors (Fry, 1988).

Supervision of financial institutions has in many countries not kept pace with their expansion and development, leading to corruption and other abuses, rendering depositors and investors unprotected. Neither has the quality of bank management and employees always improved to a desirable level.

6.2 Interest rates

Artificial low interest rate policies have been justified on the following grounds: (1) it serves as an income transfer device to help the poor, who can not afford expensive credit; 2) high rates contribute to inflation; 3) low interest rates induce borrowers to adopt new technologies and increase production; 4) such policies have been adopted in advanced economies, so why not in developing countries?; 5) the concessions provided by development assistance agencies should be passed on to farmers; 6) religious and ethical values and 7) second best alternative.

The traditional low interest rate policies have failed to achieve the primary objectives of promoting agricultural production and assisting the rural poor. They have instead undermined the financial viability of the lenders involved (Adams & Vogel, 1984). Fixed nominal interest rates on deposits, combined with inflation, limit the ability of financial institutions to mobilize savings.
The interest rate policies have encouraged households to hold a large proportion of their savings in forms such as cattle, consumer goods, precious metals, gems and art works or to engage in speculation (Adera, 1989; Von Pischke, 1991). The flight of domestic currency into these inflation hedges has reduced the amount of financial savings available for capital formation (Adera, 1989). These alternatives tend to be less efficient economically, and may lead to problems of unsustainability, eg overinvestment in livestock and overexploitation of the natural resource base. This invariably deprives intermediaries of deposits from the community as a source of loanable funds (Von Pischke, 1991). Low rates therefore encourage financial institutions' increasing dependence on government subsidies and have eroded the purchasing power of financial institutions.

Low interest rates also encourage the diversion of borrowed funds to consumption, particularly with richer farmers who are less likely to be subjected to the enforcement of requirements that loans be used only for designated purposes. Interest rate ceilings force intermediaries to ration borrowers. Increased collateral requirements and reallocation of transaction costs to borrowers are often used as a substitute for rationing mechanisms. Hence, a flexible interest rate policy which provides adequate positive real rates of interests on rural savings is necessary to promote rural savings. Bhatt (1979) generally attributes fragmentation of capital markets in the low income economies to the interest rate policies. A policy of positive real rates of interest policy, should remove these imperfections and stimulate saving and investment among the rural population.

6.3 Monetary policy

Monetary policy has definitive effects on voluntary savings. Policies such as manipulation of product and input prices and foreign exchange regulations have in many parts of the World resulted in low rural income with unequal distributions and weak incentives for rural savings. Policies leading to high and unstable inflation rates invariably encourage unproductive savings in physical goods. An effective monetary system and rational fiscal measures are therefore needed to ensure that those who hold money will have its real value preserved. Savings and credit programmes must seek to remunerate deposits with a positive real interest rate. Exchange rate policies that overvalue domestic currencies render foreign currencies relatively inexpensive, and provide incentives to buy foreign currency and goods as forms of savings or investment. It also drain funds from the domestic financial system.

Increased incomes normally lead to an increased demand for savings in general and specially for deposits. Thus personal savings should rise. No savings mobilization scheme can succeed with stagnant personal income. Savings mobilization depends on agricultural development and the attendant structural reforms. The discrimination against agriculture in some developing countries reduces income and therefore, the ability of rural households to hold deposits (Meyer, 1989).

6.4 The Political environment

Some developing country governments used financial systems as a tool for disbursing political patronage; such intrusions into financial systems create strong disincentives for borrower repayment. Political unrest diminishes confidence of savers in the financial system. A case in point is Ghana in 1981, after overthrown of the previous government. The in-coming military government demanded savers with deposits above C50,000.00 to explain to the tribunal how such monies were obtained. This severely restricted savings. A reasonable level of political stability is required for people to have trust in the broad continuity of institutions and policies (Robinson, 1994). The government's role should be to provide an enabling environment for the financial system to function efficiently.

6.5 Infrastructural development

Financial institutions in rural areas of most of developing countries are beset by problems resulting from an absence of infrastructure. Savings mobilization is often frustrated by lack of ready access to social amenities such as water, electricity, communications facilities and roads (Adera, 1984). Households choose a portfolio of investments and demand more deposits when given appropriate incentives (Khalily *et al*, 1987). The expansion of banking services in rural areas has been proven as a particularly important savings incentive to households through reduction in transaction costs (Meyer, 1989).

6.6 Informal interface with formal financial institutions

Where rural banks are non-existent or where commercial banks are ill-equipped to accept small deposits by savers, individual mobile bankers, (known as Susu collectors in Ghana) can be useful. These bankers are informal savings collectors who collect money for as little as 25 cents from their clients everyday. At the end of the month, the savings are returned to the depositors; the collectors keep 3.3 percent of the monthly savings as commission (Steel & Aryeetey, 1994). Such individual mobile bankers can act as intermediaries between savers and formal financial institutions, and strengthen savings behaviour of these mobile bankers. ROSCAs, Money lenders, trade credit and Moneykeepers may also perform this function, as can saver groups, in which members contribute savings to the groups, which then deposit money with formal financial institutions.

7. Conclusion

The reason for low institutional deposits in some developing countries is often neither undersavings nor lack of demand for financial savings instruments but the structure of services and institutions (Robinson, 1994). Various studies have shown a strong relationship between savings propensity, deposit remuneration, savings facilities and policy environment. Developing countries should place these ingredients at the disposal of the rural savers. The mobilization of savings in rural areas should be a primary function of any financial institution if it is to survive in that environment.

Note:

1. Based upon an MSc (Agric) dissertation by K. Spio at the University of Pretoria.

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