

## **Determinants of Personal Savings: A Review of Literature**

T.M. Thulani Niwanthika<sup>1</sup>

### **Abstract**

This study examines the determinants of personal savings a review of literature. Therefore, the objectives of the study are to identify the determinants of personal savings and to examine the pattern of personal savings behavior. According to the previous empirical studies, motives, savings habits, age, income, income uncertainty, wealth, risk tolerance, saving horizon, homeownership, household composition, health status, education, race/ethnicity, self-employment, and unemployment have all been linked to some aspect of saving and this determinants are directly and indirectly proportional to personal savings.

**Key words:** Personal savings, Empirical studies, Determinants,

### **Introduction**

Savings is the share of income not spent on current expenditures. In another words saving refers to the process of setting aside extra cash for future use. According to the Keynesian economics, savings consist of the amount left over when the cost of a person's consumer expenditure is detracted from the amount of disposable income earns in a given period of time.

Achieving sustainable economic growth and development are the main objectives of developing countries. There are many various policy measures and strategies have been introduced to achieve. The levels of development and differences among countries are mainly linked to their capacity for investment, capital formation, and production. The supply of resource for this investment and capital formation is largely depends on a country's savings.

National savings in an economy is an important source of investment which directly influences economic growth consists of foreign savings and domestic savings.

---

<sup>1</sup>Bachelor of Arts (Special) in Economics, Third year, thulatmtn@gmail.com

Foreign savings includes net factor income from abroad and remittances sent by migrant workers from abroad. Domestic savings include government savings and private savings.

Every country would like to have a higher rate of savings. Therefore necessity of identifying the determinants of savings and identifying the determinants of low savings are very important to a country. Nevertheless savings directly affects to the investments and investments directly affects to the development of the country. Because of that reason motivate the savings is very important to developing countries.

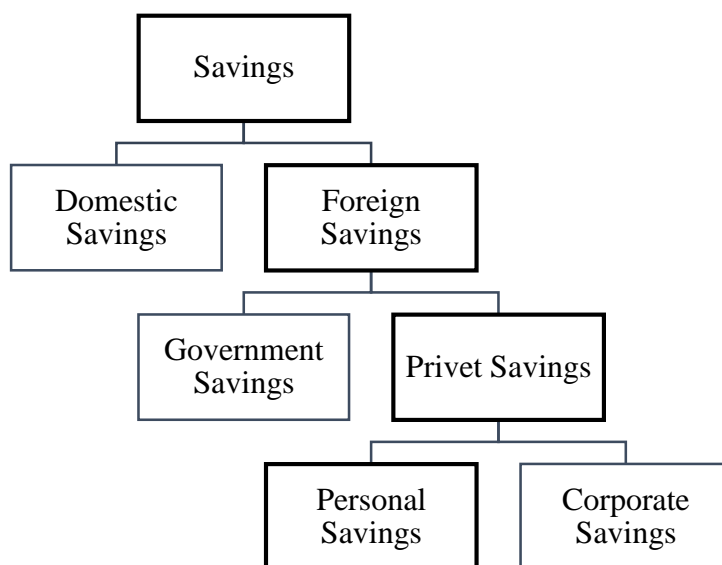
Age, gender, marital status, number of family members, religion, race/ethnicity, designation, financial literacy, education level, income, income uncertainty, knowledge about savings, consumption, motives, savings habits, wealth, risk tolerance, saving horizon, homeownership, household composition, health status, self-employment, and unemployment have all been linked to some aspect of saving. And also there are some other factors that affect how much of the personal savings as real interest rate on savings deposits, expectations of future income and job security, availability of credit, taxation of saving, repay debt, deposit for a mortgage, the availability of savings institutions, non-financial assets, .

### **Definitions and Structure of Savings**

Saving refers to the process of setting aside extra cash for future use. In another words savings is the share of income not spent on current expenditures. And also savings are the dynamic condition for the financial stability and economic growth of a country. According to Keynesian economics, savings consist of the amount left over when the cost of a person's consumer expenditure is detracted from the amount of disposable income earns in a given period of time. The levels of development and differences among countries are mainly linked to their capacity for investment, capital formation, and production. The supply of resource for this investment and capital formation is largely depends on a country's savings.

Savings in an economy is an important source of investment which directly influences economic growth consists of foreign savings and domestic savings. Foreign savings includes net factor income from abroad and

remittances sent by migrant workers from abroad. Domestic savings include government savings and private savings. The government savings simply mean the excess of the government revenue to government expenditure which reflects a current account surplus of the government budget. Private savings consist of personal savings and corporate savings. This flow of savings can be shown as below by using a flow chart.



In an economic system, personal savings can be existing in two own forms. Such as financial savings and real savings. In the developed economies, the financial aspect is wider than the real aspect. In connection with it, personal financial

Economists gave more attention about personal savings because it is a major component of determining a domestic savings of a country. According to that economists introduced many theories to define personal savings. Concerning about these theories, the more priority was given to discuss about the personal savings. With the purpose of that, this chapter apprehension how useful of these theories for a survey of identifying a determinants or behavior of personal savings and identifying the main characteristics of these theories. Finally among these theories analyse and conclusion can be given as below.

## **Importance of savings**

Achieving sustainable economic growth and development are the main objectives of developing countries. There are many various policy measures and strategies have been introduced to achieve these development goals. The levels of development and differences among countries are mainly linked to their capacity for investment, capital formation, and production. The supply of resource for this investment and capital formation is largely depends on a country's savings.

According to Lunt and Livingstone economists and social scientists often consider saving to be what is left of disposable income after consumption is decrease by (Lunt & Livingstone, 1991), but according to Katona (1975), thinking of the average person, saving refers to money put in bank accounts or other assets to protect one from future insecurities or to purchase goods and services (Katona, 1975; Lunt & Livingstone, 1991).

National savings in an economy is an important source of investment which directly influences economic growth consists of foreign savings and domestic savings. Foreign savings includes net factor income from abroad and remittances sent by migrant workers from abroad. Nevertheless these complications, it is a common practice in economics to categorize savings at a domestic level into two sub-categories, Public savings and private savings (Kudaisi, 2013; Gedela, 2012; Rehman et al., 2011). According to Mankiw (2001), public savings are mainly associated with government sector, while private savings are linked to the private sector of the economy. Implicitly, the private sector of the economy can either be category as individual household's savings and the corporate sector savings (Issahaku, 2011; Du Plessis, 2008). Of course, the government and the corporate sector are major role players in national savings, at least in terms of amount, but individual remain not only the largest contributors of savings at a national level, but are also the significant beneficiaries of these savings (Mark and William, 1999; Issahaku, 2011).

## **Empirical studies of Savings**

Even if national savings jointly consist of both privet and government savings, privet savings are the most crucial part of national savings.

Because it is evident that government savings have been recorded a negative value over a prolonged period and such public low savings has resulted from substantial fiscal deficits. Therefore policy preparations to enhance these components is insufficient. If this situation continues for a long time, it will directly affect the level of personal savings as well as total savings. Therefore it is worthwhile to identify the other determinants of personal savings in order to avoid the declining trend or to increase personal savings through expanding other determinants.

Every country would like to have a higher rate of savings. Therefore necessity of identifying the determinants of savings and identifying the determinants of low savings are very important to a country. There are some three categories of affecting factors such as; economic factors, social factors and demographic factors. However, this also implies that changing determinants from time to time would affect the savings behavior in developing countries greatly. Therefore it is important to focus briefly on the determinants that causing effects on savings in developing countries.

Privet savings are the most crucial part of national savings. Because it is evident that government savings have been recording a negative value over a prolonged period and such public dis savings has resulted from substantial fiscal deficits. Although privet savings are the crucial part in national savings in Sri Lanka, policy preparations to enhance these components is insufficient. If this situation continues for a long time, it will directly affect the level of personal savings as well as total savings.

Nevertheless savings directly affects to the investments and investments directly affects to the development of the country. Because of that reason motivate the savings is very important to developing countries. Developing countries have low government savings. Therefore motivate the personal savings is very necessary to development of the country. Thus the policy makers need to give more attention to motivate the personal savings. According to this situation, identify the determinants of personal savings is very crucial to the economic activities.

Motives, savings habits, age, income, income uncertainty, wealth, risk tolerance, saving horizon, homeownership, household composition, health status, education, race/ethnicity, self-employment, and unemployment have all been linked to some aspect of saving.

According to the previous empirical studies, they have focused mostly on the relationship between savings motives and the values donated to or held in accounts as well as consumption patterns. The current study examines the predictive influence of saving motives on saving behavior and left over saving classifications.

Saving motives are not necessarily mutually exclusive (Dyanan, Skinner, & Zeldes, 2004; Smith, 1999). For example, households may save for protective reasons but expect any unspent balances to be left as a bequest. It is unlikely that one motive will be sufficient for all members of a population at a given time or for the same person over a long period of time, and many motives are complementary. In recent years, the importance of coexisting saving motives in research on saving has been noted (Canova, Rattazzi, & Webley, 2005). Some Xiao and Noring (1994) and Xiao and Anderson (1997) found saving motives to be related to financial resources. With an increase in income, the priority saving motive of families expands from daily necessities to saving for precautionary or emergencies to children, retirement, and holidays. Xiao and Fan (2002) compared the saving motives of Chinese and American workers and found that the Chinese workers were more likely to identify motives for daily expenses, emergencies, children, and investment while Americans were more likely to report saving for major purchases and retirement. These studies and others examined the determinants of the six saving motives proposed by Katona (1975). DeVaney et al. (2007) examined the factors likely to influence progression from lower order saving motives to higher order needs on a hierarchy based on Maslow's human needs theory. However, the analysis did not examine how progress upwards on the hierarchy of savings motives could be related to saving patterns such as having a regular saving discipline which would be just as necessary as having the ability to save.

Katona (1975) proposed three categories of saving habits among average persons: first one is contractual saving, where one makes routine installment payments for an asset like a home mortgage, which is forced or obligatory saving; second one is discretionary saving, where one deliberately saves; and the third one is residual saving, where one does not spend all of income and therefore saves by default.

Many researchers have reported a positive relationship between age and savings and that saving increases with age (Chang, 1994; Katona, 1975; Mirer, 1979). Furnham (1985) found age to be strongly and linearly related to respondents' attitudes toward saving, and age has been found to determine how regularly a household saves, where a household saves, and why a household saves. Yuh and Hanna (2010) found the predicted probability of saving to be the highest among respondents under age 30, with the predicted probability generally decreasing with age.

Saving and income are positively related, with saving increasing with income (Chang, 1994; Foster, 1981; Hefferan, 1982; Lee et al., 2000; Yuh & Hanna, 2010). In the real world, uncertainty about future income affects household saving or net worth accumulation (Yuh & Hanna, 2010). Some researchers have reported that households facing higher income risk are more likely to save (Carroll, 1994; Deaton, 1991; Lusardi, 1998; Sandmo, 1970; Zeldes, 1989), while others have found no significant relationship between income uncertainty and saving behavior (Fisher, 2010).

Both positive and negative links have been found between household wealth and saving. Hefferan (1982) found a positive effect of wealth on both the decision to save and the level of saving. Rha et al. (2006) and Xiao and Malroux (1994) found a positive relationship between net assets and saving. In Yuh and Hanna (2010), net worth had a positive effect on household saving practices. However, Chang (1994) argued that increases in wealth have a negative effect on personal saving, holding all else equal, finding initial net non-housing assets to be negatively related to non-housing asset accumulation.

Households with a high level of risk tolerance accumulate more non-housing wealth than those with low risk tolerance (Chang, 1994). Avery and Kennickell (1991) found that households expressing a willingness to bear high risks have much higher levels of saving. Fisher and Montalto (2010) found that low risk tolerance decreased the likelihood of saving, and Finke and Huston (2003) found that greater risk tolerance was associated with higher net worth and financial assets.

Saving behavior is distorted by an individual's health status (Davies, 1981; Palumbo, 1999), and Kennickell and Lusardi (2005) argued that it is important to model health risks in studies of consumption and saving.

Several researchers have found that health affects total wealth growth (National Bureau of Economic Research, 2000; Smith, 1999; Wu, 2003), and Fisher and Montalto (2010, 2011) found a negative relationship between poor health and saving. However, Yuh and Hanna (2010) found that households with poor health are more likely to save than households with fair or excellent health.

Solmon (1975) indicated that average and marginal propensities to save rise with the educational attainment of the household head. In a study of saving in Britain, Furnham (1985) found education had a curvilinear differentiation effect on household heads' (who response to the questions) attitudes related to saving. Saving has been shown to be higher among higher education groups (Attanasio, 1993; Avery & Kennickell, 1991; Bernheim & Scholz, 1993; Lee et al., 2000), while wealth holdings have been shown to be particularly low for households whose head has low education (Bernheim & Scholz, 1993; Hubbard, Skinner, & Zeldes, 1995). According to the Rha, Montalto, and Hanna identified that households with a college degree or an advanced degree were significantly less likely to save than otherwise similar households where the head had a high school diploma (Rha, Montalto & Hanna; 2006).

Using 1983 and 1986 data from the Survey of Consumer Finances, Chang (1994) found that savers, those who accumulated non-housing assets between 1983 and 1986, were less likely to be farm and self-employed workers compared to dis-savers. Chang (1994) also found that more savers than dis-savers were employed in 1983 and 1986. On the contrary, Rodriguez, Flores and DeVaney (2007) found that the self-employed were more likely to have adequate emergency funds. Yuh and Hanna (2010) found that self-employed households were more likely to save than those that were not self-employed. This would suggest they were more likely to be savers to buffer income uncertainty, but whether they save regularly or irregularly is yet to be determined.

There are some other factors that affect how much of the personal savings as Real interest rate on savings deposits because of the return on savings adjusted for inflation, Expectations of future income and job security or all linked to consumer confidence, Availability of credit borrowing to finance extra spending counts as dis-saving, Taxation of saving e.g. tax efficient savings schemes and tax relief on occupational pensions such may encourage



people to put away more of their disposable income, The need to save to repay debt e.g. property owners stuck in negative equity where their house is worth less than their mortgage debt or families that need to cut their debts on credit cards, A need to save to build up a deposit for a mortgage, pay school and university fees, and save for retirement in an occupational pension scheme, The availability of savings institutions such as banks and our trust in those institutions. Mwegu, (1990) observed that one of the main determinants of savings is interest rate. It is generally believed that a higher interest rate encourages savings. According to McKinnon, (1973) and Shaw, (1973), low interest rate discourages savings mobilization and the channeling of the mobilized savings through the financial system. This eventually has a negative impact on the quantity and quality of investment, the entrepreneurial development and the economic growth. The impact of interest rate on personal savings is however not straightforward in the sense that the raising of interest rates have two effects that work in the opposite direction. There is the substitution effect which causes savings to increase as consumption is postponed to the future and the wealth effect in which savers increase current consumption at the expense of saving. The impact of interest rate on saving will therefore depend on which of the two effects will dominate. Study on the effect of real deposit rate on saving in Kenya by Mwegu, (1990) shows no significant effect in contrast with McKinnon and Shaw, (1973) hypothesis. The hypothesis argues for a positive impact of interest on saving for a less developing country that's financial and bond market is underdeveloped.

## **Conclusion**

Personal Saving is necessary in every nations in bid to achieve economic growth and development. The levels of development and differences among countries are mainly linked to their capacity for investment, capital formation, and production. The supply of resource for investment and capital formation are largely depend on a country's savings. However, the determinants of personal savings differ from cross countries, there are hardly find many studies concerned in Sri Lanka in order to identify the determinants of personal savings. In spite of the importance of savings for poor households, only 37% of grown person in developing countries have savings accounts, and in many settings, fewer than half of the people who open accounts ever

use them for deposits or withdrawals (Central Bank Report, 2013). Access to low cost savings accounts can profoundly affect the amounts households save, invest, and consume. People save for various reasons as old age, education, foreign travel, to buy goods, houses and lands, illness and hospitalization and to meet any unexpected expenses. Motives, savings habits, age, income, income uncertainty, wealth, risk tolerance, saving horizon, homeownership, household composition, health status, education, race/ethnicity, self-employment, and unemployment have all been linked to some aspect of saving.

## References

- Attanasio, O. P. (1993). *A cohort analysis of life-cycle accumulation of financial assets*. *Economic Research*, 47, 323-354.
- Avery, R., & Kennickell, A. B. (1991). *Household saving in the U.S. Review of Income and Wealth*, 37, 409-432.
- Canova, L., Rattazzi, A. M., & Webley, P. (2005). *The hierarchical structure of saving motives*. *Journal of Economic Psychology*, 26, 21-34.
- Carroll, C. (1994). *How does future income affect current consumption?* *The Quarterly Journal of Economics*, 109, 111-148.
- Central Bank of Sri Lanka (2013). *Economic and social statistics of Sri Lanka*, Central Bank of Sri Lanka, Colombo 12.
- Chang, Y. R. (1994). *Saving behavior of U.S. households in the 1980s: Results from the 1983 and 1986 Survey of Consumer Finances*. *Financial Counseling and Planning*, 5, 1-21.
- Davies, J. (1981). *Uncertain lifetime, consumption, and dissaving in retirement*. *Journal of Political Economy*, 89, 561-78.
- Deaton, A. (1991). *Saving and liquidity constraints*. *Econometrical*, 59, 1221-1248.
- deposits.org. (2016, 04 22). *www.deposits.org*. Retrieved from [http:// www.deposits.org/dictionary/ term/ savings](http://www.deposits.org/dictionary/term/savings).

DeVaney, S. A., Anong, S. T., & Whirl, S. E. (2007). *Household savings motives*. The Journal of Consumer Affairs, 41, 174-186.

Dynan, K. E., Skinner, J., & Zeldes, S. P. (2004). *Do the rich save more?* Journal of Political Economy, 112, 397-444.

Fisher, P. J. (2010). *Gender differences in personal saving behaviors*. Journal of Financial Counseling and Planning, 21, 14-24.

Foster, J. F. (1981). *The reality of the present and the challenge of the future*. Journal of Economic Issues, 15, 963-968.

Furnham, A. (1985). *Why do people save? Attitudes to, habits of, saving money in Britain*. Journal of Applied Social Psychology, 15, 354-373.

Hefferan, C. (1982). *Determinants and patterns of family saving*. Home Economics Research Journal, 11, 47-55.

Katona, G. (1975). *Psychological economics*. New York: Elsevier.

Livingstone, S., & Lunt, P. (1993). *Savers and borrowers: Strategies of personal financial management*. Human Relations, 46, 943-985.

Lunt, P., & Livingstone, S. (1991). *Psychological, social and economic determinants of saving: Comparing recurrent and total savings*. Journal of Economic Psychology, 12, 621-641.

Lusardi, A. (1998). *On the importance of the precautionary saving motive*. American Economic Review Papers and Proceedings, 88, 449-453.

McKinnon, R. (1973). *Money and Capital in Economic Development*. Washington D.C. Brookings Institution.

Mwega, F., Ngola, S. and Mwangi, N. (1990). *Real Interest Rates and the Mobilization of Private Saving in Africa: A case study of Kenya*. AERC Research Paper 2.

National Bureau of Economic Research. (2000, February). *Choice, chance, and wealth dispersion at retirement*. (NBER Working Paper No. 7521).

Cambridge, MA: Venti, S. F., & Wise, D. A. Retrieved from <http://www.nber.org/papers/w7521.pdf>

Rodriguez-Flores, A., & DeVaney, S. A. (2007). *The effect of employment status on households' emergency funds*. *Journal of Personal Finance*, 5, 67-84.

Sandmo, A. (1970). *The effect of uncertainty on saving decisions*. *Review of Economic Studies*, 37, 353-360.

Shaw, E. (1973). *Financial Deepening in Economic Development*. Oxford: Oxford University Press.

Wu, S. (2003). The effects of health events on the economic status of married couples. *Journal of Human Resources*, 38, 219-230.

Xiao, J. J., & Fan, J. X. (2002). *A comparison of savings motives of urban Chinese and American workers*. *Family and Consumer Sciences Research Journal*, 30, 463-495.

Xiao, J. J., & Malroux. (1994). *saving motivation and saving behavior of the elderly*. *Consumer Interest Annual*, 40, 156-163.

Xiao, J. J., & Noring, F. E. (1994). *Perceived saving motives and hierarchical financial needs*. *Financial Counseling and Planning*, 5, 25-44.

Yuh, Y., & Hanna, S. D. (2010). *Which households think they save?* *Journal of Consumer Affairs*, 44, 70-97.

Zeldes, S. P. (1989). *Consumption and liquidity constraints: An empirical investigation*. *Journal of Political Economy*, 97, 305-346.