Policy Advisory

No. 2004-04

MOBILIZING DOMESTIC SAVING

Congressional Planning and Budget Department
House of Representatives

Abstract

The gross domestic saving of the Philippines as a ratio to gross domestic product—termed as saving rate in this paper—has been dismally low since the early 1990s. The saving rate of 16.7% in 2001 is still below the 21.1% rate in 1988.

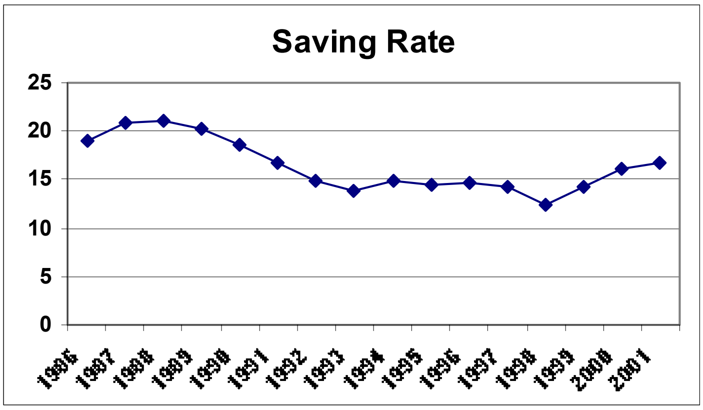
Saving is very important to the economy as this provides the funds for developmental activities. Thus, to some extent, saving determines the investment performance of a country. Investments, in turn, promote development as these increase economic activities and provide employment opportunities.

This paper reviews the saving performance of the country and examines policy options to improve the saving rate.

Saving Performance

The saving rate of the country over the period 1990-2001[1] has been dismally low and has not exceeded the peak level of 21.1% attained in 1988. The saving rate bottomed out at 12.4% in 1998 right after the Asian financial crisis, increasing thereafter until reaching 16.7% in 2001—roughly equivalent to the saving rate a decade ago.

Meanwhile, other countries in the region have consistently posted high saving rates of over 20% for the same period, except in 1999 and 1995 for Indonesia and Vietnam, respectively. Singapore and Malaysia posted high average saving rates of over 40%.



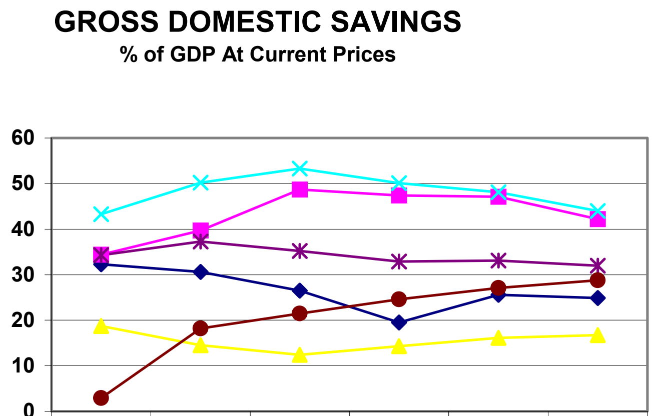
Source of basic data: Philippine Statistical Yearbook, Various Years
National Income Accounts, as of May 2002

A. Cross-country Comparison of Saving Trends

Over the last decade, the ratio of gross domestic saving to GDP of the Philippines has been one of the lowest in Southeast Asia. While the saving rate continuously improved starting 1998 and reached 16.7% in 2001, it is still way below the 34.4% average saving rate of five Southeast Asian countries—Thailand, Indonesia, Malaysia, Vietnam, and Singapore—for the same period.

[1] While 2002 and 2003 data are already available, the data coverage of this study is up to 2001 only, utilizing the old series of the national income accounts to ensure consistency and continuity of data. The National Statistical Coordination board (NSCB) is currently undertaking revisions, including rebasing of the data series to 2000, of the national income accounts. The new series will be released in November 2004.

Singapore has the highest average saving rate, even posting more than 50% in some years. Malaysia came next with average saving rate above 40%. Thailand consistently posted above 30% saving rate. While the saving rate of Indonesia declined from its average rate of over 30% in the early 1990s to as low as 19.5% in 1999, it has bounced back in the next two years to settle at 24.9% in 2001. Vietnam consistently showed significant improvement in its saving rate from only 2.9% in 1990 to 28.8% in 2001.



	1990	1995	1998	1999	2000	2001
Indonesia	32.3	30.6	26.5	19.5	25.6	24.9
Malaysia	34.4	39.7	48.7	47.4	47.1	42.2
Philippines	18.7	14.5	12.4	14.3	16.1	16.7
Singapore	43.3	50.2	53.3	50.1	48.1	44.0
Thailand	34.3	37.3	35.2	32.9	33.1	32.0
Viet Nam	2.9	18.2	21.5	24.6	27.1	28.8

Source: Key Indicators of Developing Asian and Pacific Countries
Asian Development Bank

B. Saving and Investment

Saving is primarily used to finance investments. When domestic resources are not enough to finance investment requirements, external sources are tapped to fill in the gap. While sourcing from foreign savings has its own benefits, it makes the country highly vulnerable to external downside risks.

The country posted its last saving-investment surplus in 1988 amounting to P26 billion at current prices or about 3.3% of GDP. In 1997 during the Asian financial crisis, the saving-investment deficit fell to its lowest at -10.2% of GDP. From thereon, it continued to improve (although still at a deficit), reaching –0.5% of GDP in 2001.

The reduction in the saving-investment gap could be mistaken for better utilization of available domestic resources and lower dependence on foreign savings. However, the improvement was more a result of a decline in the investment rate (current fixed capital investment over current GDP) rather than an improvement in the saving rate. After the Asian financial crisis, the investment rate began to decline from an annual average of 23.5% over the period 1994-1997 to 21.1% in 1998 and further worsening to 17.3% in 2001.

Saving and Investment Gap
In Billion Pesos
At Current Prices

	1994-1997 Average	1998	1999	2000	2001
Gross Domestic Saving*	298	331	426	533	610
As % of GDP	**14.5**	**12.4**	**14.3**	**16.1**	**16.7**
Fixed Capital Investments	481	564	568	614	629
As % of GDP	**23.5**	**21.1**	**19.1**	**18.6**	**17.3**
Saving-Investments Gap	-184	-233	-142	-81	-19
As % of GDP	**-9.0**	**-8.7**	**-4.8**	**-2.4**	**-0.5**

**/ Gross domestic saving is derived from the national income accounts data of the NSCB using the formula: GDS = GDP – PCE – GC, where PCE is personal consumption expenditure and GC is government consumption. The numbers derived are consistent with the data published by the Asian Development Bank in its Key Indicators of Developing Asian and Pacific Countries, 2003.*
Source of basic data: National Statistical Coordination Board (NSCB)

In spite of the steady improvement in the saving performance starting 2000, it is nonetheless important to increase the saving rate further to reduce the country's dependence on foreign saving as well as to ensure the sustainability of investments. The saving rate in 2001 is still low compared with the rate in the late 1980s. Moreover, the investment rate of 17.3% in 2001 is way below the average rate of about 23.5% from 1991 to 1997. The country needs to mobilize its resources to finance investments to attain and surpass pre-crisis levels.

C. Sources of Saving

Over the years, saving came mainly from the private sector, which comprises two groups—the household and unincorporated enterprises and private corporations. In particular, saving of the household and unincorporated enterprises provide the biggest contribution to gross domestic saving (GDS). For the period 1998-2001, this sector accounted for an average of 68% of GDS, almost double its average share of 38.6% from 1994 to 1997. In 2001, the saving of households and unincorporated enterprises amounted to P590 billion at current prices, or about 96.7% of GDS.

Meanwhile, saving of private corporations was adversely affected by the Asian financial crisis. In 1997, its share to the GDS went down to 15.9% from an average of 36.6% for the period 1992 to 1996. This sector posted P94 billion saving at current prices in 2001.

Sources of Gross Domestic Saving
In Billion Pesos
At Current Prices

Sector	1994-1997 Average	1998	1999	2000	2001
Gross Domestic Saving*	**298**	**331**	**426**	**533**	**610**
Private Corporations	81	57	90	87	94
Government Corporations	13	13	17	20	24
General Government	89	22	8	-64	-98
Households & Unincorporated Enterprises	115	238	312	488	590

**/ Using the amount derived from the preceding table. The breakdown of GDS was derived using the percent distribution of breakdown of net national savings as presented in the Consolidated Accounts III: Gross Accumulation of the National Accounts as published by the NSCB.*
Note: Details may not add up due to rounding off errors.
Source of basic data: National Statistical Coordination Board (NSCB)

The other source of saving is the public sector, which consists of the national government and government-owned and controlled corporations (GOCCs). The combined contribution of these two institutions to the gross domestic saving continually declined after the Asian financial crisis. After posting surpluses in the years 1994 to 1997, the contribution of general government to GDS fell sharply to 6.8% in 1998 from 26.9% in 1997. In 2000 and 2001, consistent with the shoot up in the budget deficit, general government became a net borrower—its contribution to GDS was –12% and –16.1%, respectively.

The contribution of GOCCs to GDS also decreased, albeit marginally, from an average of 4.4% for the period 1994-1997 to 3.3% for the period 1998-2001. This can be traced to the worsening financial condition of the GOCCs and the declining subsidy from the national government.

Causes of the Weak Saving Performance

There are many factors that determine the saving performance of a country. The most important factors are those related to income, demographic structures, and the extent of financial sector development.[2] The weaknesses of these three factors are primarily responsible for the relatively poor saving performance of the Philippines.

Low level and growth of per capita income. The capacity of a household to save depends primarily on its earning capacity or the level and growth of personal income as well as its sustainability. High and sustained growth in per capita income tends to increase the savings rate.

In 2001, per capita GDP of the Philippines was $1050, approximately equal to the level in 1995. The country has not achieved a significant improvement in per capita income because of the boom-bust nature of economic growth. The per capita GDP of the country is only better off than Indonesia and Vietnam with $680 and $410 per capita GDP, respectively. However, these two countries, particularly Vietnam, have better per capita growth rates. And if the trend continues, it is very likely that Indonesia and Vietnam will surpass the Philippines' per capita level in the coming years. Meanwhile, Malaysia and Thailand have far better per capita of $3,640 and $1,970, respectively.

High dependency ratio. Demographic factors also affect saving performance. When there are too many young people to support, consumption increases and saving declines. Several cross-country studies show that both the rate of growth of population and the share of population below 15 years of age have a negative relationship with the saving rate.[3]

The age structure of the Philippine population in 2000 is a typical broad base at the bottom of the pyramid consisting of large number of children (0 to 14 years) and a narrow top made up of relatively small number of elderly (65 years and above). The dependency ratio in 2000

---

[2] As most analyses show particularly in the study of N. Loayza, K. Schimidt-Hebbet and L. Steven, "What Drives Private Saving Across the World?" The Review of Economics and Statistics, vol. LXXXII, No. 2 (May 2000), pp.165-181.
[3] Evidence of Southeast Asia indicates that a reduction in population growth increases the savings rate by reducing the young dependant cohort. Stefano Manzocchi, Foreign Capital in Developing Economies: Perspectives from the Theory of Economic Growth (New York, St. Martin's Press, 1999), pp. 49-51 and 123-125.

is 69.04—which means that every 100 persons in the working age group (15 to 64 years) had to support 69 dependents[4] (NSO 2002). The dependency ratio in 1995 was 69.6.

Based on the 2000 Census of Population and Housing conducted by the National Statistics Office, the total population of the Philippines as of May 2000 is 76,504,077 persons, or about 2.36% average annual growth rate for the period 1995-2000. If this rate were to continue, the population would increase, on the average, by about 1.8 million persons annually and would reach about 100 million after 14 years. Meanwhile, Thailand, Vietnam and Indonesia have lower average annual population growth rate of about 1%, 1.5% and 1.3%, respectively.

Underdeveloped financial sector. The degree of financial sector development also affects saving. When the capacity to save exists, the decision to save in monetary terms will depend on the credibility and convenience of financial institutions. Savings will be kept in non-monetary terms such as jewelry, real estate, among others when financial institutions are not strong and stable. This will defeat the main purpose of saving which is to channel the resources to more productive uses.

The liberalization of the banking industry attracted foreign banks to operate in the country. It also resulted in the several mergers of commercial banks which made them stronger to be more ready to compete with the foreign banks. However, these did not result in significant increases in the saving rate and the growth of credit. The country's financial intermediation ratio—calculated as M3/GNP and measures the extent of financial deepening—is only 0.39 in 2001, lower than Vietnam's 0.53 and Indonesia's 0.61. Countries such as Thailand and Malaysia have over 1.0 financial intermediation ratio.

Furthermore, the Asian financial crisis in 1997 weakened the banking system through the rise in non-performing loans. Total non-performing loans (NPLs) of commercial banks more than doubled to P73.6 billion in 1997 from only P34.2 billion in 1996. In 1998, it again grew more than 100% to P160 billion. As a result, the NPLs to total loans ratio soared to 10.3% in 1998 from only 2.8% in 1996, and reached its peak of 18.8% in October 2001. As of December 2003, NPLs to total loans ratio tapered off to 14.1%.

Low real interest rates. The effect of real interest rates (discounting for inflation) in most studies is not clear but there is evidence which shows that the significance of interest rate on saving increases as the income level of a country rises. Interest rate sensitivity for middle and upper-income groups is relatively much higher.[5]

---

[4] About 63 persons from the young group and about 6 persons from the old group

[5] Masao Ogaki, Jonathan Ostry and Carmen Reinhart, "Saving Behavior in Low- and Middle-income Developing Countries," IMF working Paper WP/95/3, 1995, pp.25-26

In the Philippines, low interest rate on savings coupled with the tax on interest income has been a disincentive to saving. Average savings deposit rates for 2003 is 4.2%.[6] However, availment of this interest rate is still subject to the required average daily balance.

Weak fiscal position of the government. The saving performance of the national government continually declined over the years when it started to incur budget deficits. The last time the national government recorded a budget surplus was in 1997 amounting to P1.6 billion. The surplus was not sustained because it was more a result of an increase in revenues derived from privatizing government assets, which are one-time transactions. Moreover, the tax effort of the government also declined from its peak of 17% in 1997 down to 12.3% in 2003. Last year, the budget deficit reached P199.2 billion, representing 4.3% of GNP.

Furthermore, huge subsidies to government owned and controlled corporations (GOCCs) put additional burden on the consolidated public sector deficit. From January to September 2003, the consolidated public sector deficit amounted to P133.4 billion or about 4.3% of GDP.

What has been done?

Liberalization of the banking industry. The Foreign Banks Liberalization Act was enacted into law in 1994. Republic Act No. 7721, which liberalized the entry and scope of operations of foreign banks in the Philippines, stepped up competition in the domestic market. Furthermore, Republic Act No. 8791 or the General Banking Law of 2000 authorized foreign banks to acquire up to 100% of the voting stock of only one bank organized under the laws of the country. It also allowed foreign, banks which availed of the privilege to acquire up to 60% of the voting stock of a bank under RA 7721, to further acquire voting shares to the extent necessary for it to own 100% of the voting stock.

Increased competition forced commercial banks to continuously improve their product offerings. This resulted in the increase in the variety of saving schemes offered by banks. However, even with the interesting features, the returns are still not high enough to attract savers. For example, the Bank of the Philippine Islands offer a maximum of 3%[7] interest rate for its savings accounts.

Issuance of Retail Treasury Bonds (RTBs). In May 4, 2001 the Bureau of the Treasury (BTr) began to issue Retail Treasury Bonds (RTBs) through government-owned banks such as Land Bank of the Philippines and the Development bank of the Philippines, among others. RTBs are direct and unconditional obligations of the national government which primarily caters to the retail market. They are alternative forms of investment which are safe, liquid and offer attractive returns, market-determined, to investors. The maturity period varies from three to five years and they can be traded in the secondary market before maturity.

---

[6] Refers to the annual percentage equivalent of the 10 sample commercial banks' actual monthly interest expense on peso-savings deposits to the outstanding levels of these deposits. Source: Table 19 of Monthly Selected Philippine Indicators of the BSP. *www.bsp.gov.ph*

[7] To earn this interest rate, the daily balance of the account should be P1M above. Based on the "Pricing Update" brochure as of January 1, 2004.

Since the first issue date, the BTr has already auctioned RTBs four times in the market. Total RTB issuances for the period 2001 to 2003 amounted to only P206.8 million. Before the BTR offers to the market, it seeks authority from the Office of the President which would indicate the ceiling of the amount to be issued.

Securitization Law. The passage of the Securitization Act in 2004 could further improve domestic saving in the country that could help finance investment growth. This law is expected to further facilitate the development of the capital market and attract additional saving
as asset-backed securities serve as alternative investment instruments that can be used for housing, infrastructure, and other development activities.

The law provides the regulatory framework for the sale of assets such as loans, mortgages, receivables and other debt instruments as new securities to raise capital. Under the law, assets may be sold without recourse to special purpose entities which can issue securities backed up by a pool of similar assets, thereby distributing risk.

Recommendations

Saving is important as it provides the source of funding to finance investments that are crucial in promoting economic development.

Fiscal policies have immediate impact on saving. Given that the national government is in a fiscal bind, it has to effect much needed tax policies to improve revenue efforts and consolidate its fiscal position to ultimately contribute to enhancing domestic saving. Prudence must be exercised on the expenditure side—there are still many expenditure items that can be more efficiently managed.

Other measures to increase saving normally work over the long term. Macroeconomic stability, competitive returns on financial saving instruments, development of the capital markets as well as reforms in the administration of the pension system are among the important measures to increase saving.

Ensure sustained economic growth. It is essential to break the boom-bust cycle of economic growth in the country. Sustained economic growth will improve per capita income and may, in turn, improve saving mobilization. Several cross-country and time-series studies in saving behavior indicate that growth in real GDP have positive impact on savings. In particular, a study by N. Loanza, et al (2000) showed that high and sustained growth in per capita tends to increase the savings rate.

Enhance financial sector development. There is a need to address the weaknesses of the banking sector to enhance its credibility. Priority should be to geared towards lessening the high level of non-performing loans (NPLs) of banks which stood at P245.5 billion as of December 2003 representing a ratio of 14.1% to total loans. The high NPLs tend to reduce the confidence of potential depositors in the ability of banks to honor their obligations. These also increase the spread between the borrowing and lending interest rates which make the returns on savings less attractive. Further liberalizing the banking sector would increase competition in the banking sector.

Encourage long-term household savings. The capital market is not well developed. A huge proportion of the population is not aware that there are other forms of saving schemes aside from depositing the money in the bank. It is important to increase the awareness of the people in other saving instruments such as saving in mutual funds to give them a wider choice of saving schemes and higher returns for their investments.

Products of pre-need companies such as pension plans should also be extensively promoted. Although these products do not have the flexibility of bank deposits as the money is locked up for a minimum number of years, the return is higher. Some products even offer a protection plan along with these instruments.

Relatedly, the passage of the Personal Equity Retirement Act (PERA) should be prioritized. This bill seeks to promote a long-term saving and investment scheme that would encourage majority of Filipinos to save for their retirement years. The bill provides that contribution to the savings funds is deductible from the taxable income and the earnings are only subject to tax upon withdrawal. Please refer to ***Annex*** for a detailed description of House Bill No. 6001 on the Provident Personal Savings Plan known as the “Personal Equity and Retirement Account (PERA)”.

Formulate and implement a coherent population policy. A transition to a smaller household size can help improve the saving rate. When the number of people to support is smaller, consumption will be lower and saving could be higher. Lower fertility rates will also reduce both infant and maternal mortality rate. Thus, it is important that the government promote a rational population policy that will not only help Filipinos manage their households but may also help increase the saving rate.

Annex

The House of Representatives approved on August 4, 2003 **House Bill No. 6OO1** entitled ***"An Act Establishing a Provident Personal Savings Plan known as the Personal Equity and Retirement Account (PERA),"*** and transmitted to and received by the Senate on August 5 and 7, 2003, respectively.

Salient Features

- Annual PERA contributions of not more than P50,000 but may be adjusted from time to time is deductible from the taxable income;
- Investment income from the contributions is tax-exempt;
- Investors can keep track and even directly manage their contributions as an investment portfolio;
- PERA contributions may be transferred to high investment levels to take advantage of prevailing market conditions.

Sources/References:

Asian Development Bank. Country Economic Review: Philippines
Asian Development Outlook 2003
Asian Recovery Information Center Database
Bangko Sentral ng Pilipinas Database
Bureau of the Treasury Data
General Banking Law of 2000 (R.A. No. 8791)
House Bill No. 6001 "An Act Establishing a Provident Personal Savings Plan known as the Personal Equity and Retirement Account (PERA)
Loayza, N., K. Schimidt-Hebbet and L. Steven, "What Drives Private Saving Across the World?", The Review of Economics and Statistics, vol. LXXXII, No. 2 May 2000
Manzocchi Stefano. Foreign Capital in Developing Economies: Perspectives from the Theory of Economic Growth. New York, St. Martin's Press, 1999
National Statistical Coordination Board Data
National Statistics Office Data and Press Releases
Tanhueco, Honorina. Determinants of Savings and Investment in the Philippines
Unite, Angelo A. and Michael J. Sullivan. "Has Foreign Entry Made Domestic Banks More Efficient?" Policy Notes, October 2002. Philippine Institute for Development Studies
United Nations Economic and Social Cooperation for Asia and the Pacific. Domestic Resource Mobilization