

➤ What determines savings?

Here are fourteen factors that are supposed to affect savings.

1. **Income Variable**

Following both the Keynesian approach and the permanent income hypothesis it is hypothesized that the savings rate is positively related to the growth in national income because more surplus income means a higher savings rate in the economy. The GDP growth rate and per capita income are used alternatively as income variables in all the savings functions.

2. **Domestic Real Interest Rate**

The impact of the domestic real interest rate on domestic savings is a controversial issue among economists. On the one hand it is argued that an increase in the real interest rate tends to encourage domestic savings through the substitution effect. On the other hand, current consumption is derived from current income through the income effect, resulting in less savings. But the empirical evidence suggests that the real interest rate is positively related with the savings rate. This study hypothesizes that an increase in the real interest rate provides an incentive to the household sector to save more. With a relatively higher interest rate, the corporate sector also generates its savings due to the higher cost of borrowing loans from domestic banking and non-banking institutions.

3. **Domestic Credits**

Bank credits to the private sector are expected to have a negative impact both on household and corporate savings. Instead of domestic bank credits to the public sector, total domestic transfers to the public sector from banking and non-banking institutions are used in the analysis, assuming a negative relationship between domestic transfers and public savings. In fact, the availability of bank credits discourages the efforts of institutional agents to enhance their own savings.

4. **Inflation Rate**

It is assumed that the expected inflation rate has a negative impact on household and corporate savings. Because of the anticipation of a higher inflation rate in the future, people substitute their future consumption for present consumption, consequently saving less.

5. **Foreign Interest Rate**

A higher foreign interest rate may encourage people to transfer their savings abroad, thereby reducing household and corporate savings, as regards public savings, a higher interest rate on foreign debt means that the burden of debt servicing increases. Thus, foreign interest pushes the government to raise its domestic resources, resulting in increased public savings. The US prime rate is an appropriate measure of the foreign interest rate.

6. **Export Earnings**

The export sector is presumed to have an independent impact on the propensity to save and is a critical source of both private savings and government revenues. Export earnings allow the gross domestic product to rise by relieving the foreign exchange constraints, consequently increasing domestic savings. It is also argued that the export sector provides greater profits due to relatively higher prices in international markets. Therefore, the savings propensity for export earning may be higher than in the other sectors of the economy.

7. **Terms of Trade**

Harberger, and Laursen and Metzlet, postulate that savings out of any given income falls with deterioration in the terms of trade because a decline in export earning means a fall of current income and consequently reduction in domestic savings. On the other hand, Obstfeld argues that savings may increase with deterioration in the terms of trade because the economy is forced to spend less on imported goods to maintain a target level of real wealth, thereby savings more. In this study, changes in the terms of trade are included in all the savings functions to facilitate empirical examination of these controversial arguments.

8. **Private Capital Outflows**

Private sector capital is like a migratory bird because when the weather is not favourable, it simply moves on to safer pastures. In Pakistan nationalization measures and political unrest in country during the 1970s and 1980s discouraged private sector economic activities, resulting in huge capital outflows from Pakistan. Moreover, capital flight resulted in a reduction of available resources to finance domestic investment, eventually leading to decline in the rate of capital formation. This phenomenon has adversely affected the country's current and future growth and savings rates. Capital outflow hurt not only private savings but also public savings in Pakistan. Government revenue collections have declined as a result of private capital outflows, so have, consequently public savings.

9. **Workers' Remittances**

Workers' remittances are expected to have a positive impact on household savings because a large part of remittances are saved by the families of emigrants in Pakistan. A survey done by Gillani and Amjad revealed that 35 to 40 per cent of remittances were saved/invested by the families of emigrants in Pakistan.

10. **Dependency Ratio**

A well-known demographic variable, the dependency ratio, is also included in the household saving function. The influence of the dependency ratio on household savings in developing countries has remained a controversial issue in the literature. [A number of scholars] have found a strong negative relationship between the dependency ratio and the saving rate. Counter to this, [others] have found no significant influence of the dependency ratio on domestic savings.

11. **Net Foreign Capital Inflows**

In the economic literature, the relationship between foreign capital inflows and domestic savings has received considerable attention during the last three decades. Initially, the complementary approach was adopted. More recently, the hypothesis has been put forward that an increase in the foreign capital inflow exercises a depressing effect on domestic savings. [In our work we] focus on how the net foreign capital inflow impacts on the private sector with reference to corporate savings. The justification of not including the foreign capital inflow in the household saving function is that Pakistan is an official borrower and most of its foreign loans come through official sources. The impact of net foreign capital on the public sector is also analyzed in the public saving function.

12. **Profitability**

Profit is considered as a primary determinant of private corporate savings. Therefore, a positive impact of profitability on corporate savings is expected.

13. **Real Wage Rate**

It is hypothesized that a higher bias towards labor may be determinantal to corporate savings because an increase in real wage in the large-scale manufacturing sector raise the cost of production, consequently reducing profits. Thus, a negative correlation is expected between the real wage rate and the corporate saving rate.

14. **Debt Servicing**

A negative relationship between public saving and debt servicing is expected, as every year 17 to 20 per cent of total revenues are spent on debt servicing in Pakistan, which is expected to be saved by the public sector.