

UNIVERSITY OF KWAZULU-NATAL

The Impact of Tax-free Investments on Savings in South Africa

By

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Abstract

Since democratic transition in 1994, South Africa has experienced impressive growth in economic and per-capita income. However, the country still remains entrenched in deep-rooted structural problems of unemployment and income polarisation. Macroeconomic policy has attempted to redress these setbacks but outcomes envisaged by policy-makers have not materialised. One of the key lessons learnt from other emerging economies that have achieved elevated degrees of socio-economic growth is that high levels of investment and capital accumulation are pertinent and that these variables are funded from high saving rates. Unfortunately, since financial liberalisation and the relaxation of credit controls over the last four decades, many consumers are burdened by debt and a lack of disposable income leading to low levels of household savings. In an attempt to redress this, National Treasury introduced a new form of tax-incentivised investments in the hope of revitalising savings. Given this backdrop, this study aims to analyse the extent that tax-free investments will rejuvenate household savings. A quantitative method was adopted and a survey conducted amongst financial advisors to ascertain their opinions on the factors that affect savings and whether tax-free investments would have the necessary impetus to entice additional savings. Furthermore, a comprehensive literature review was compiled to record the observations of researchers who conducted similar studies. Measures of success were determined by the extent to which tax-free investments met the criteria of policy-makers. This study concludes that although tax-free investments are cost-effective saving vehicles that are offered by many service providers, tax policy still lacks the ability and appeal to penetrate the masses and to significantly improve the level of savings required for elevated investment and capital accumulation. Tax policy must take more cognisance of socio-economic conditions to allow consumers to generate the cash flow required for saving.

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CHAPTER ONE

Introduction

1.1 Background

According to the World Economic Forum (2012), South Africa's gross national savings rate was 17% of gross domestic production and considered low in comparison to other emerging economies such as China and India, whose saving rates were 51% and 32% respectively. Furthermore, the country was ranked at 52 out of 144 on the global competitive index. National savings have generally been considered crucial to improving economic development as they generate additional investment and industrial growth (Zwane *et al.*, 2016). During 2012, the South African Government released a series of discussion papers to promote household savings and to reform the retirement industry (National Treasury, 2012). These papers highlighted Government's concern over the low levels of household saving and affirmed its commitment to increasing levels of financial security for all citizens. One of the proposals that Government recommended was the introduction of tax-free investment schemes for natural individuals where income and capital growth would be exempt from taxation and therefore act as an incentive to promote higher savings. These tax incentives were promulgated in 2015 and are now commonly referred to as tax-free savings or investment accounts.

This study attempts to assess the impact of the newly introduced tax incentives on the financial landscape and evaluate its ability to revitalise household savings. This study will first examine theoretical models of savings and consumption and consider their relevance to the South African backdrop. Macroeconomic and demographic factors are then analysed to determine their applicability to South African consumers. It concludes by summarising key findings revealed by researchers on international tax-incentivised schemes and whether they are consistent with local observations.

1.2 Problem Statement

The primary reason for the introduction of tax-free investments is to promote household savings predominantly amongst the low- to middle-income groups and to foster a culture of saving. Thus, to be effective, tax policy should provide sufficient stimulus to change saving and consumption patterns. Furthermore, it is essential that new savings must emanate from reduced consumption as opposed to existing savings being redirected to more tax-efficient vehicles. International studies of similar tax incentivised schemes have revealed that these schemes are dominated by higher-income groups and that assets are widely being shifted from one saving scheme to more tax-efficient ones, thus creating very little increase in net savings (Alarie, 2009); (Donnelly & Young, 2012); (Kesselman, 2015). Hence, it is important to observe the trends in South Africa to ascertain whether policy meets tax reality and to take corrective measures where necessary.

1.3 Motivation for the Study

Although South Africa has made commendable socio-economic gains since democratic transition, the country has a long way to go to achieve its future goals of eliminating poverty, raising living standards and reducing inequality as set out in the National Development Plan 2030 (National Planning Commission, 2011). The plan sets out a series of deliverables including the creation of jobs, expanding infrastructure, improving education and healthcare and fighting corruption. However, at present, the country is plagued by high levels of poverty, unemployment and inequality and these factors remain the fundamental socio-economic challenges facing South Africa (Faulkner *et al.*, 2013). Furthermore, a culture of material consumerism exists that has led to high levels of debt servicing and low disposable income (Mail and Guardian Online, 2013).

National Treasury has addressed these challenges by introducing tax-incentivised saving accounts to foster additional savings which ultimately should lead to financial security for citizens and economic growth. However, improving household savings as a means of resurrecting economic prosperity is a complex topic and care should be taken to ensure that any legislation promulgated to this end takes

due cognisance of the various factors that affect savings. Thus, while the introduction of tax-free investments can be broadly considered a step in the right direction towards improving savings there is still uncertainty as to whether this initiative will, in its current form and practice, be sufficient to dramatically improve net savings and concomitant economic prosperity. Therefore, this study will critically analyse the impact of tax-free investments on the saving's landscape and suggest recommendations to ensure that tax policy has the desired effect of improving household savings.

1.4 Research Objectives

This study will be guided by the following research objectives:

- To review published literature and determine behavioural, demographic and economic factors that affect levels of household saving
- To research international legislation designed to invigorate savings via the tax system and subsequently compare international observations to local trends
- To ascertain key socio-economic variables that affect levels of household savings in South Africa
- To account for the implementation of tax-free investments in South Africa
- To determine the extent that tax-free investments will invigorate household savings in South Africa

1.5 Research Questions

The study attempts to answer the following key questions:

- What are the key socio-economic variables that affect levels of household saving in general and to what extent are they applicable to South African consumers

- How successfully have international tax-incentivised schemes improved overall levels of saving in their respective countries and what insight can international observations provide as to the potential success of tax-incentivised saving schemes locally
- How successfully have tax-free investments been implemented in South Africa and are they geared to improve household savings

1.6 Methodology

In order to collate data, a questionnaire was administered to employees of a branch of a reputable insurance and investment company in South Africa. No sampling techniques were conducted as the target population consisted of the entire team of staff and ranged from all levels of experience and seniority in order to eliminate bias. A 5-point Likert scale was used to measure respondent's opinions and attitudes. The results of the survey were analysed using the SPSS data analysis package.

1.7 Expected Outcome

The expected outcome of this study is to determine the influence that tax-free investments will have on improving household savings based on the perceptions of financial consultants and to identify areas of concern which should be addressed by policymakers.

1.8 Focus of the Study

This study will focus on section 12T of the Income Tax Act (National Treasury, 2015) which regulates the taxation of tax-free investments. Furthermore, other macro- and micro-economic components that affect savings and consumption will be examined to determine their influence on the savings behaviour in South Africa. Reference will also be made to international research publications that have studied the impact of similar tax incentives in their respective countries.

1.9 Expected Limitations of the Study

This study was limited to the perceptions and opinions of financial consultants from a branch of one insurance company. The inclusion of other tax-free service providers including banks, stockbrokers and other insurance companies will provide a more universal opinion.

1.10 Structure of the Study

This is a quantitative study. The first chapter introduces the problem of low savings amongst South African households, the tax-incentives developed to improve this and the limitations to this study. Chapter 2 will encompass a literature review on consumption and saving models, factors that affect savings and the mechanism of tax-free investments. Conclusions observed in similar studies on tax-incentivised schemes will also be analysed. Chapter 3 covers the research methodology employed. Chapter 4 encompasses the presentation and analysis of the results from the surveys conducted. Chapter 5 discusses the research findings, concludes the study and engenders recommendations for future study.

CHAPTER TWO

Literature Review

2.1 Introduction

This chapter begins with a brief introduction into the definition of saving and reports the saving trend in South Africa over the last four decades. Economic models and other variables that have attempted to explain the consumption and saving relationship and behaviour of consumers are then examined. This is important because any legislation that attempts to increase the saving rate needs to take cognisance of the financial and behavioural factors espoused by these models and variables. Tax-free investments are then discussed in relation to local and international observations.

2.2 Definition of Saving

Saving is defined by economists as income not spent or that part of after-tax disposable income not consumed (Janse van Rensburg *et al.*, 2011). Thus, saving has the effect of deferring consumption till a future date so that an individual can prepare for contingencies or emergencies. Savers forgo current consumption in an attempt to supplement future income via rental, investment and dividend receipts and through capital appreciation. In the absence of saving, unexpected events can become large financial burdens.

National or aggregate saving comprises of saving by business, government and private households. The net saving of a country is collectively defined as the country's income or gross domestic product less private and government or public consumption (Frank & Bernanke, 2011). Ideally, private and public consumption should exclude investment spending as this spending expands future productive capacity as opposed to satisfying current needs.

The formal definition of household saving used by the South African Reserve Bank is that part of current income, after the payment of direct taxes (mainly income tax payments), that is not consumed or transferred as part of household current

consumption (Prinsloo, 2008). Expenditure that is financed via the use of credit instead of current income increases financial liabilities and is regarded as negative saving. Personal saving is usually subdivided into contractual saving such as periodic contributions to investment, life and retirement saving and discretionary saving which is generally not bound by fixed obligations. An increase in contractual saving accompanied by a corresponding increase in liability leaves aggregate personal saving unchanged.

The graph below highlights the trend in household, corporate and government saving in South Africa since 1994.

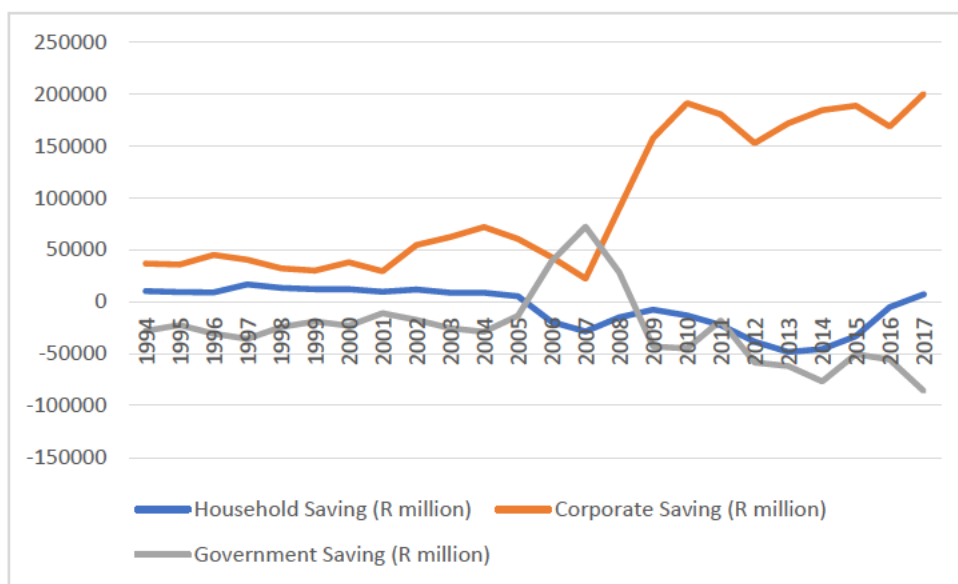


Figure 2.1 Annual Savings Trends

Source: South African Reserve Bank, 2018. *Online Statistical Query*

Both government and household savings have declined while corporate savings has increased. Since 2014, household savings has shown a steady upward trend.

The graph below depicts the ratio of gross savings to gross domestic production (GDP) of South Africa over the last 4 decades.

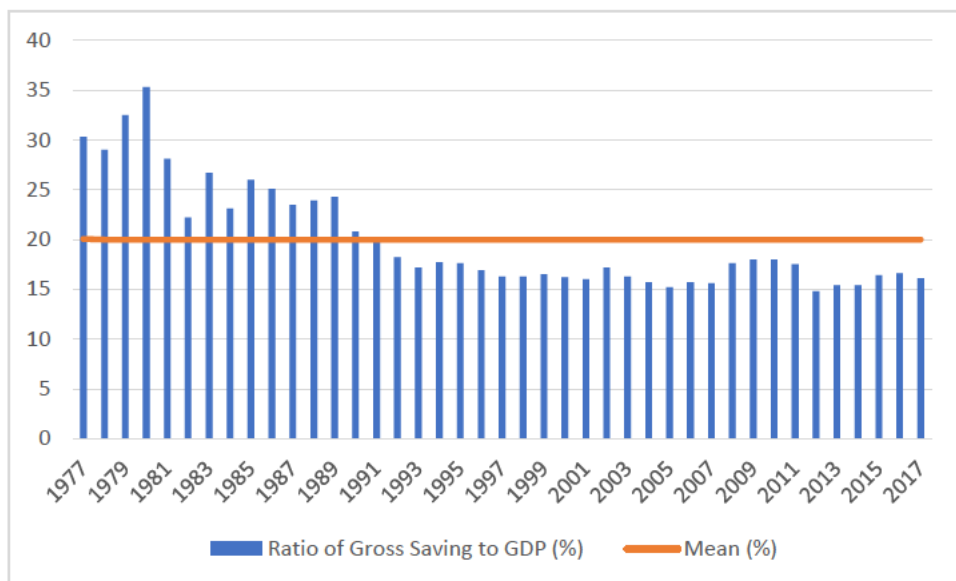


Figure 2.2 Savings to GDP Ratio

Source: South African Reserve Bank, 2018. *Online Statistical Query*

Since 1979, there has been a steady decline in the gross savings ratio from 35.3% to 16.1% in 2017. This is relatively low compared to some of the country's emerging economy counterparts with India and China boasting a saving ratio of 30% and 50% respectively (Mongale *et al.*, 2013). Low savings is detrimental to growth as it constrains investment and exacerbates currency fluctuations (Simleit *et al.*, 2011). Improving levels of household saving will muster domestic resources and incentivise investment which in turn gives rise to industrial growth, increased employment, currency stability and economic development (Zwane *et al.*, 2016).

2.3 Theories of Consumption and Saving

The first theory developed to model consumption behaviour is known as Keynes's General Theory and is considered to be the origins of macroeconomics (Parker, 2010). Keynes proposed that consumption was a product of income and that consumption and saving will increase as income increases. Another early model developed by James Dusenberry proposed that consumption habits are not only

dependent on current income but past income and income of other households and thus known as the Relative Income Hypothesis.

Other theories arise from a combination Milton Friedman's Permanent Income Hypothesis and Modigliani's Life Cycle Hypothesis and have merged to be known as the modern consumption theory (Simpson *et al.*, 2011). While both models emphasise consumption smoothing, Modigliani contends that the level of consumption is dependent on the various stages of an individual's lifetime whereas Friedman contends that consumption is a factor of an individual permanent income. The most recent model is known as the Instantaneous Gratification Model (Laibson, 2005).

2.3.1 Keynes's General Theory

Keynes's consumption model states that there is a direct relationship between consumption and income (Janse van Rensburg *et al.*, 2011). As income increases, consumption will increase though not in the same proportion as the increase in income. The propensity to consume is the actual consumption that takes place at the different levels of income. Where consumption exceeds income, dissaving occurs and implies that households must borrow money or dip into prior savings to consume.

Saving is defined as the excess of income over consumption and the volume of saving fundamentally depends on the level of income. As stated earlier, increases in income lead to increases in consumption but at a relatively lower rate. Hence, the reduction of consumption in proportion to increase in income yields higher savings. Hence, low-income groups below a specified income level may not save additional income but consume all income on essential living expenses. As income rises further, saving will occur in low-income groups but at a rate lower to high-income groups as a greater proportion of additional income is still being consumed on essentials in comparison to higher income groups. High income groups have the highest propensity to save and low-income groups the least. This represents a significant challenge to policymakers who hope to encourage savings amongst the poor.

The graph below represents the relationship and trends between disposable income, consumption and saving in South Africa over the previous four decades.

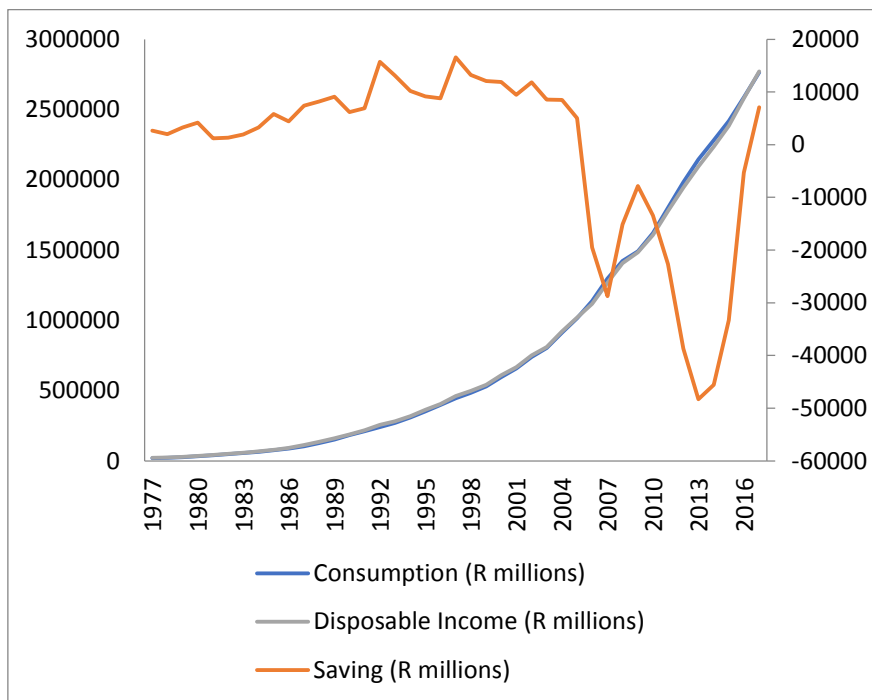


Figure 2.3 Relationship between Consumption, Saving and Disposable Income

Source: South African Reserve Bank, 2018. *Online Statistical Query*

Contrary to Keynes's model that consumption should increase at a diminishing rate to increases in disposable income, the above graph suggests that both variables increased in tandem with each other. Hence, consumption and disposable income share a direct relationship as growths in disposable income nearly match growths in consumption. However, saving has remained relatively flat from 1977 to 1997 and then dropped sharply till 2013. Saving began to increase with income from 2013 onwards. Hence, increases in disposable income have had a mixed effect on saving.

Overall, the ratio of saving to disposable income has declined sharply over the last 40 years, as evidenced in the graph below.

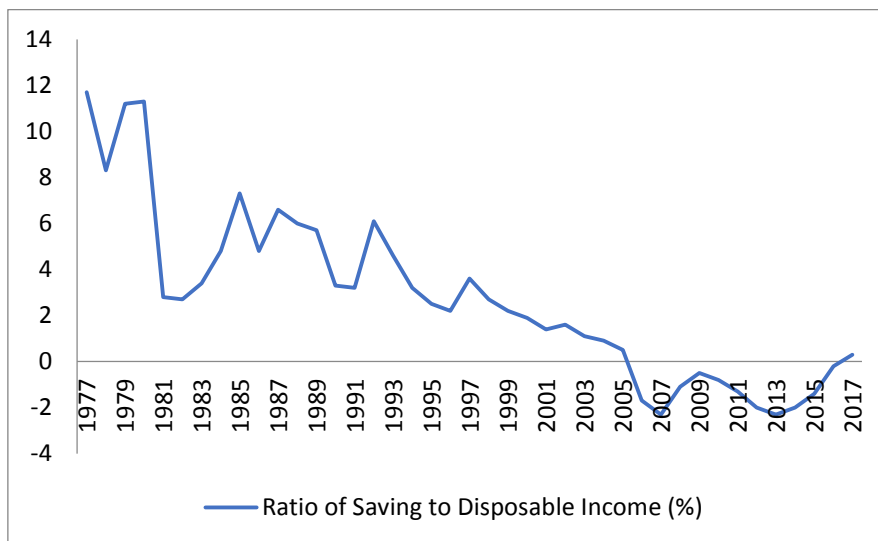


Figure 2.4 Ratio of Saving to Disposable Income

Source: South African Reserve Bank, 2018. *Online Statistical Query*

Contrary to Keynes's view that saving should increase relative to increases in disposable income, the above graph indicates that saving was on a relatively downward trajectory till 2013 and then began to steadily increase to date. This indicates a low saving culture even in midst of rising income.

2.3.2 The Relative Income Hypothesis

Keynes consumption model suffered drawbacks in that it was based on introspection as opposed to observed facts and post-war empirical data cast doubts on the validity of Keynes's consumption function (Dwivedi, 2005). The first attempt in researching the above contradiction was carried out by Dusenberry (Parker, 2010) which yielded the relative income hypothesis. The relative income model has a cross-section variant and a time-series variant. The first variant is synonymous with the analogy of "keeping up with the Joneses" whereby an individual's consumption behaviour does not just depend on that individual's current income but also on the consumption behaviour of other individuals in a similar subgroup. Hence, consumption by an individual depends on their income relative to the incomes of other individuals in society and households attempt to

align their spending habits with those of other members of a group. This implies that low income households may spend a higher proportion of income just to keep up with other low-income households while higher-income households still have the propensity to save more.

The time-series variant refers to the situation where a household's permanent income falls but their spending habits remain unchanged leading to the accumulation of debt. This is contradictory to Keynes's model which holds that consumption would decrease if income decreases. Dusenberry termed this observation as the ratchet effect which signifies household's resistance to reduce consumption in proportion to the fall in income because households are used to a standard of living. However, Dwivedi (2005) has noted that the irreversibility of consumption standards only holds true in the short term as dissaving cannot be maintained in the long run. The relative income hypothesis can provide an indication to policymakers on the psychological motives of differing consumers and adjust policy or education.

2.3.3 The Permanent Income Hypothesis

Whereas Keynes related consumption to current absolute income and Dusenberry related consumption to current relative income, Milton Friedman rejected the current income hypotheses and developed the permanent income theory of consumption (Stuart, 2016). Friedman distinguished between normal levels of income expected to be earned over a person's life, which he called permanent income, and positive or negative deviations from that level, which he termed transitory income. According to this theory, savings will be high when current income is high relative to permanent income; i.e. when transitory income is high. Hence, perceptions of future income play an important role in the savings decision process. Where people anticipate future higher income, they will raise present consumption and reduce savings. Alternatively, where perceptions of future income are low, such as impending unemployment, consumption will reduce, and savings will increase.

2.3.4 The Life-Cycle Hypothesis

According to this premise, consumption in any period is a function of the individual's age and the resources available to him (Hussein *et al.*, 2017). Resources consist of present net wealth and the present value of existing and future prospective labour income. Furthermore, the model assumes that the consumer rationally plans their consumption behaviour based on the value of their resources and maximises their total utility over the course of their life time.

Hence, an individual attempts to smooth consumption over the span of their life based on an allocated portion of lifetime income and accumulated wealth. Early in one's life, an individual may borrow from the future and consumption will exceed income as they invest in capital assets such as homes, family planning, education and vehicles. During mid-life an individual tends to repay past borrowings via additional income earned and consumption patterns tend to level off resulting in increased savings and wealth creation for future years. At retirement, consumption will once again exceed income and past savings may be utilised to finance consumption. The model implies that dissaving will occur at the beginning and end of one's life with positive saving occurring in the middle years.

According to Dwivedi (2005), several shortcomings are evident in the life-cycle hypothesis because the model makes use of strong and unrealistic assumptions. The model assumes that an individual has a definite vision of the future size of his income and is aware of other variables that could affect income. Furthermore, the model assumes that an individual has all the information he needs to plan complex calculations and has the ability to plot present and future consumption with consistency and replicability.

Dirschmid and Glatzer (2004) suggests that countries with a high population in the young and elderly age groups increases dependency within households which, in turn, leads to dissaving as they erode the savings of the active population. Triantis (1997) disagrees with the hypothesis and suggests that declines in income of retirees are mitigated by reductions in work and family related expenditures and because consumption habits become more risk averse. Factors that boost overall

national savings are more likely to have a positive impact on the savings of retiree due to their prudent nature.

Research by Ting and Kollamparambil (2015) suggests that savings in South Africa does not follow a hump-shaped pattern as required by the life-cycle hypothesis because consumption is retained during retirement years through government grants. However, it was noted that a substantial part of grants was channelled towards saving. Hence, government grants have a dual effect of sustaining consumption levels while disincentivising savings during the working years.

2.3.5 Instantaneous Gratification

According to Laibson (2005), the purchasing behaviour of consumers display a high degree of impatience choosing immediate pleasures or instant gratification over patience and associated larger rewards that can be reaped. However, this only applies to short term decision making as people tend to display patience for long term decisions. Consumers have a tendency to quickly splurge on liquid assets today and vow to save for tomorrow in the form of illiquid assets. This implies that people have a tendency of save in illiquid assets such as homes and investments that offer a higher rate of return or a steady future income stream but are also disposed to pay a high price for instantaneous gratification such as high interest credit card purchases. Another pertinent observation is that consumers that require instant gratification often procrastinate on long term saving decisions and often choose default saving options. Hence, if the default option for new employees was no automatic saving enrolment, then they would choose that option (Madrian & Shea, 2001). Thus, any saving policy should preferably mandate automatic enrolments to encourage participation.

2.4 Importance of Household Saving

Research conducted by Lugauer and Steven (2013) on the impact of household saving in China concluded that high saving rates promoted capital accumulation and investment spending which consequently drove economic growth. Of the three components of saving, household saving exceeded government and corporate

saving and that real investment was financed by domestic sources of saving. Investment spending was the primary driver of national growth which has in turn lifted millions out of subsistence-level poverty.

In South Africa low levels of saving are insufficient to finance higher investment leading to large structural saving and investment gaps (Mongale *et al.*, 2013). Hence, the country depends on foreign savings to support investment and growth leading to a higher current account deficit. This reliance on foreign capital inflows subjects to country to high currency fluctuations and macroeconomic instability via interest and inflation spikes. Higher national saving reduces the country's reliance on volatile capital inflows (National Treasury, 2012) and promotes wealth accumulation and economic security. Household saving improves a person's ability to absorb expenditure shocks and reduces one's reliance on excessive debt to fund short term necessities.

2.5 Determinants of Saving

This section provides a brief overview of the variables that are expected to influence the level of national saving. From a South African viewpoint, the determinants that affect saving are complicated by the socio-economic legacies of apartheid which have ostracised many citizens from conventional saving instruments and the mainstream economy and that have stripped many blacks of productive assets such as land and education. This has led to high levels of poverty, income inequality and unemployment (Zwane *et al.*, 2016). Other factors affecting the propensity to save include wealth, debt, consumer confidence, age dependency, inflation and interest rates (Samantaraya & Patra, 2014). These factors could either be permanent or transitory shocks with permanent shocks having a more pronounced influence on consumption than transitory shocks (Jappelli & Pistaferri, 2010).

2.5.1 Financial Education

In a study conducted by Beckmann (2013) financial literacy was positively and significantly correlated to saving and investment. Low literacy and lack of information affect the ability to save and to secure a comfortable retirement. Ignorance about basic financial concepts can be linked to lack of retirement planning and lack of wealth. Financial education programs can help improve saving and financial decision-making, but much more can be done to improve the effectiveness of these programs (Mahdzan & Tabiani, 2013). Higher occupational and educational levels raise investment risk and widens investment choice (Bhatt & Bhatt, 2012). According to the Financial Services Board (2015), the lack of financial literacy exposes investors to predatory lending and financial scams.

Syden (2014) also emphasises that although government needs to be taking the lead in fostering a better savings mind-set amongst its citizens, the financial services industry needs to play a significant role in promoting financial education to break the barriers to saving. A large proportion of the populous are inadequately served by the industry (Finscope, 2016) and the financial sector needs to understand the demographic dynamics to service the grassroots masses. Tax-free accounts need to be explained in layman's terms and be cost-effective to attract the lower-income groups.

2.5.2 Income and Poverty

Recent studies (The World Bank, 2018) have indicated that approximately 76% of South Africans tackle the challenges of poverty on a daily basis. Furthermore, the country is characterized by high levels on income polarisation as there are high levels of low-income earners compared to a minute percentage of very high-income earners. Middle-income earners represent a small percentage of the population.

As discussed earlier, Keynes's general theory stated that household saving is primarily a function of disposable income and that as income increases consumption will increase at a diminishing rate thus paving a way for increased saving. This viewpoint has been widely supported but the causal relationship

remains contentious from an empirical point of view (Zwane *et al.*, 2016). Studies by Horioka and Wan (2007) supports the view of a positive relationship between household saving and income. From a South African perspective, this viewpoint was supported by studies conducted by Mongale *et al.* (2013), Mahlo (2011) and Zwane *et al.* (2016). However, other studies supported the viewpoint of a negative correlation between income and saving because increases in economic growth drives consumption due to optimism leading to a fall in savings (Chipote & Tsegaye, 2014), (Simleit *et al.*, 2011).

2.5.3 Age and Dependency

The life-cycle hypothesis provides a direct link between saving and age groups whereby saving is more prominent in middle-aged groups and less so amongst retirees and the young. This was reiterated by Abu *et al.* (2013) who maintained that younger individuals save to build a safety net for utilization during their retirement years. Chavali and Mohanraj (2016) observed that risk tolerance is greatest amongst the 21-30 years age group and that elder respondents are more cautious. In another study conducted by Heena (2015), it was found that females are more risk averse than men and that, single and unmarried individuals are greater risk takers. Although men and youngsters are greater risk takers than women and the elderly, there remains a great deal of reluctance to investing in risky assets because of financial scarcities and lack of investment opportunities (Bashir *et al.*, 2013). Income was positively correlated to risk tolerance with businessmen and personality type A people to be the greatest risk takers when compared to salary earners and personality type B people respectively. Risk tolerance increases at a diminishing rate with increases in income.

Young- and old-age dependency in families reduce savings (Loayza *et al.*, 2000). Zwane *et al.* (2016) used panel data estimations to theorise a positive correlation between household saving and income in South Africa but also emphasised a negative correlation to age and head of the household as increased household sizes places an additional drain on savings. In a survey amongst South Africa's working metropolitan population (Old Mutual, 2017), one-third of the respondents believe that the government would take care of their needs at retirement. 53% of

low-income respondents (those earning less than R6 000 per month) believe that their children would take care of them. The term 'Sandwich Generation' has been coined to describe those who are supporting not only children but also parents and other older dependents (Old Mutual, 2017) and accounts just under a third of the sample.

2.5.4 Savings Culture

According to du Plessis (2008) the propensity to save is part of the established culture of a nation. In East-Asia, for example, households regard it of great importance to have and maintain a comfortable "nest-egg" in the form of accumulated saving. South Africa has predominantly been a consumption led economy (Grobler, 2015) indicating a culture of spending rather than saving. In terms of Laibson's instantaneous gratification theory (2005), individual consumption habits seek immediate and extravagant pleasures as opposed to prudent behaviours. This notion was reinforced by the National Youth Development Agency, who commented that South African youth are obsessed with a culture of material consumerism and strive for instant gratification often fueled by aggressive marketing campaigns and easy access to unsecured lending (Mail and Guardian Online, 2013). The Agency eluded that a cultural turnaround towards sacrifice, self-regulation and adopting a long-term outlook is required to improve savings.

2.5.5 Economic Growth

The Harrod-Domar growth model is utilised by developed economies to explain an economy's growth rate in terms of saving and investment (Samantaraya & Patra, 2014). The model predicts that economic growth can be improved either by increasing the level of national saving or reducing the capital output ratio. National saving is used to fund investment which in turn influences aggregate demand and improves national production capacity. This model was succeeded by the Solow-Swan model which regarded saving as a mechanism for capital accumulation (Djawoto *et al.*, 2014). Saving facilitated a higher growth in per capita capital and per capita income. However, a study of the relationship between low private

savings in New Zealand and its potential effect on growth (Claus *et al.*, 2001), concluded that investment and growth were not hampered by low domestic savings. Investments may be financed domestically or from foreign capital and unless there are barriers to international capital mobility, funds will flow to investment projects with the highest expected rates of return. Although increased private saving would lower foreign interest paid and increase future national income, this comes at a cost to private households by means of reduced consumption.

Many economists have studied the relationship between economic growth and saving and have come to different conclusions as to which variable is the precursor to macroeconomic policy (Djawoto *et al.*, 2014). According to the preceding authors, the Solow growth model predicts that higher saving precedes and leads to higher economic growth and that further studies have concluded that saving is crucial to economic growth due to an increase in investment levels. Proponents of Keynes's theory, however, suggest that an increase in national output will increase income and thereby increase national and household saving. Research conducted in Nigeria also concluded that economic growth has higher impact on higher savings (Abu, 2010).

However, Najarzadeh *et al.* (2014) argues that there is a long-run causal relationship between savings and growth and that these relations are two-way. This view is also reinforced by Turan and Gjergji (2014) who contends that there is a cointegrated and positive long-run relationship between savings and growth. A further complication to the direction of the causal relationship was introduced by Mohan (2006) who studied this relationship in countries with differing income levels and found the Keynesian model to hold true for countries with low-income levels whereas the Solow hypothesis was applicable to countries with high-income levels.

The examination of the causal relationship between savings and growth is important because it guides policy makers in their decisions. If savings is perceived to precede economic growth, then policies that promote the mobilisation of saving should be employed. However, if the belief is that growth precedes

saving then obstacles to economic growth should be removed. Policymakers may also introduce a combination of growth and saving incentives to achieve their desired result. In a recent study in Lesotho by Sekantsi & Kalebe (2015), the authors concluded that there is a relationship between investment, saving and growth in the long run. Causality was also found to be running from growth to saving in the short run. However, the results concluded that causality ran from saving to growth in the long run in Lesotho.

According to Muragodlu and Taskin (2007), variables that determine savings behaviour for developing countries are not valid for industrial countries and vice versa. Hence, policymakers must assess the level of development in a country before simply adopting policies designed for developed economies. Industrial countries are conducive to policies that induce high levels of growth and disposable income as a means to improving savings. However, developing countries respond better to the introduction of new and more sophisticated financial markets and associated instruments. Financial liberalization will provide a conduit for channeling income into financial instruments in developing economies and thus enhancing savings.

The figure below indicates the relationship between savings and economic growth in South Africa.

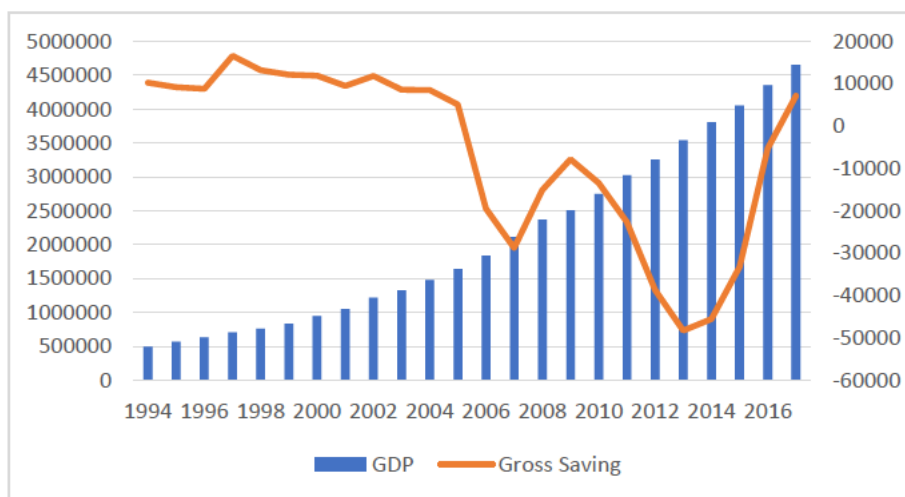


Figure 2.5 Economic Growth and Saving
 Source: South African Reserve Bank, 2018. *Online Statistical Query*

From 1994 to 2007, gross domestic production grew steadily while gross savings decline. This inverse relationship was also observed from 2009 to 2013. Savings had a direct relationship with growth for a short period from 2007 to 2009 and then from 2013 onwards. Hence, it seems that causality in South Africa runs from growth to saving in the long term.

2.5.6 Financial Liberalisation and Debt

Financial liberalization refers to the deregulation of the financial system to allow the forces of supply and demand to act as a proxy for price (Sulaiman *et al.*, 2012). The effects of liberalization are reduced credit constraints on households, reduced collateral on asset purchases and an increase in the availability of access to loan facilities. During the 1970's and 1980's, several developing countries were constrained by financial repression (Ahmed & Islam, 2010) whereby loans were subsidized for specific sectors, banks were crippled by severe regulation and interest rates were capped and distorted resulting in weak and uncompetitive financial markets. In South Africa, financial repression existed in the form of credit ceilings in the 1960's and 1970's, and 1967 saw the South African Reserve Bank placing limits on loans that banks were permitted to grant. Financial liberation began with the removal of interest and credit controls in 1980, followed by banks enjoying a substantial reduction in liquidity ratios between 1983 and 1985. Policies that limited bank competitiveness were abolished in 1983. Despite prior liberalization, capital controls were constricted again in 1985 and foreign exchange controls maintained because of economic sanctions and the risk of capital flight.

According to Akinsola and Odhiambo (2017), most international organisations like the World Bank and International Monetary Fund have advocated the introduction of financial liberalization policies to augment higher saving, investment and rapid economic growth in developing countries. Liberalisation promotes stability as diverse and liquid financial instruments help absorb economic shocks. However, financial liberalisation is no panacea and will not improve economic performance unless accompanied by sound economic policies. Furthermore, there is a point beyond where such benefits begin to decline, and costs start to rise (Sahay *et al.*, 2015). The relationship between financial development and growth is bell shaped

and marginal returns diminish at high levels of development resulting in a tradeoff as costs begin to outweigh benefits. Furthermore, the pace of financial development is significant as too fast a pace leads to instability.

A South African study conducted by Kapingura and Alagidede (2016) examined the link between financial sector development and savings mobilisation between 1980 and 2012 using the life-cycle hypothesis as a theoretical background. The researchers concluded that there is a direct relationship between financial liberalisation and savings as liberalisation increases competition within the banking sector leading to a market-determined interest rate. Furthermore, increased competition encourages financial innovation and reduced costs to investors.

Research carried out by International Monetary Fund (2012) indicates that financial liberalization encourages borrowing which lead to excessive debt and thus had a negative effect on private saving. The dangers of excessive debt were reinforced by Prinsloo (2002) who observed an inverse relationship between saving and consumption on credit and that the deregulation of the financial sector during the 1980s has ultimately reduced household saving.

The graph below depicts the relationship between credit extended to households and gross saving.

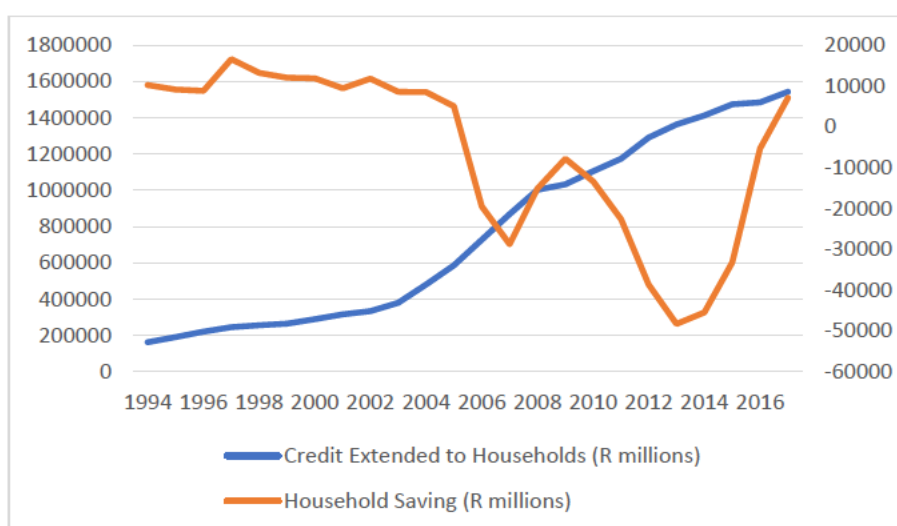


Figure 2.6 Credit Extensions and Household Saving

Source: South African Reserve Bank, 2018. *Online Statistical Query*

Household consumption plays a significant role in economic growth in South Africa as it accounts for 60% of gross domestic production (South African Parliamentary Budget Office, 2017). Hence, it is important to evaluate factors that could reduce investment and associated growth, one of them being levels of household indebtedness. The diagram above indicates that South Africans significantly increased their levels of debt leverage up until the 2008 global financial crisis as easy access to credit contributed to credit-fuelled consumption and large increases in household debt. Debt to disposable income ratios grew from 54% in 2002 to 87% in 2008 (South African Parliamentary Budget Office, 2017). Thereafter, a large amount of income was spent servicing those debts which resulted in disinvestment from capital growth assets and a slowdown in national growth. This was also accompanied by a steep drop in savings until 2013. Hence, high levels of debt servicing reduce growth in that reduced household aggregate demand results in reduced business output and a slowdown in investment and employment. Mongale *et al.* (2013) confirmed that a negative relationship exists in South Africa between household debt and saving.

2.5.7 Inflation

Inflation is broadly defined by economists as a rise in the general level of prices (van Rensburg *et al.*, 2011) and has the effect of reducing the purchasing power of money. This, in turn, reduces disposable income since each Rand of income will buy fewer goods and services than before. Inflation has a redistribution effect of real income or income adjusted for inflation. Smaller increases in income in relation to increases in inflation will reduce savings as the cost of a basket of goods increases at a higher rate than marginal income. Furthermore, unanticipated increases in inflation severely impact fixed-income earners and savers. People living on a private pension or retirement annuity will see the purchasing power of that pension or annuity diminish should inflation rise. Similarly, as prices rise at a faster rate to interest income, the purchasing power of accumulated savings decrease, and formerly adequate paper assets may not suitably meet emergency or retirement funding requirements. In South Africa,

inflation has a positive effect on saving as households make precautionary savings based on economic uncertainty (Syden, 2014).

According to Simleit *et al.* (2011) empirical studies on the association between savings and interest rates are inconclusive. According to the authors, financial liberalisation in industrial economies created a significant positive effect between real interest rates and saving. Higher interest rates spurred investors to save for a higher future return as opposed to the rewards of current consumption. The relationship between the two variables in developing countries is negative and insignificant.

These findings were also observed by Muragodlu and Taskin (2007). The income and substitution effects of rising interest rates, for example, has an indeterminate effect on consumption as there are opposing motives at play. The income effect of a rise in interest rates would lead to higher income for the wealthy which in turn would stimulate higher consumption. Conversely, there is a substitution effect where higher rates stimulate people to save more or borrow less thus deterring consumption.

In South Africa, the association between short-term interest rates and household savings is negative and significant (Simleit *et al.*, 2011). Higher real rates and economic upswings explain the decline in household savings since the 1980's. Studies by Kapingura and Alagidede (2016) and Mongale *et al.* (2013) also confirmed a negative long run relationship between household saving and interest rates. The inverse relationship implies that South Africans are net borrowers and an increase in interest rates will raise the cost of financing existing debt and thus reduce income which can be directed towards saving.

2.5.8 Taxation System

According to Arnold (2008), the link between overall tax levels and economic growth is uncertain and even if a correlation was identified the direction of causality is unclear. The link between tax structures, as opposed to tax levels, and growth is more conclusive. The author concludes that property taxes and consumption taxes are more effective for stimulating growth than personal or

corporate income tax. Frank and Bernanke (2011) and O' Sullivan *et al.* (2009) discuss the implications of income tax being replaced by a consumption tax. The idea behind consumption tax is that individuals should be taxed on what they consume and not what they produce. Reducing consumption in relation to production would lead to savings which could be ploughed back into the economy. Hence, consumption tax would incentivize savings. However, based on the life-cycle and permanent income hypotheses, consumption smoothing will lead to higher consumption. Furthermore, tax reductions may induce household savings but reduce national savings in the long run.

According to Strydom (2015), the South African tax system discourages household saving. It is biased towards corporate tax as opposed to personal income tax as corporate taxes are lower. Hence, tax arbitrage would entice households to invest in corporate enterprises. However, shifting from personal to corporate savings should not pose a problem (Simleit *et al.*, 2011). Furthermore, capital gain taxes force households towards credit-based transactions to fuel consumption as liquidating assets would attract high capital gain taxes. Lastly, taxes on interest income reduce real rates of return and force households to switch from discretionary saving in favour of financial assets. The previous authors' viewpoint was supported by Mongale *et al.* (2013) who recommended a reduction in personal taxes as a means to boost disposable income and an increase in consumption tax to generate fiscal revenue.

2.6 South African Tax-free Investments

In his 2012 Budget Speech, Finance Minister Pravin Gordhan announced the release of a series of discussion papers aimed at cultivating measures to invigorate household savings, improve governance over pension funds and to improve preservation of retirement fund assets to ensure high levels of income in retirement (2012). The supplementary Budget Review highlighted the need for such reforms citing that too few South Africans had adequate income upon retiring because of the prevalence of an inadequate savings mentality amongst citizens or them not having access to appropriate savings vehicles (National Treasury, 2012). Hence, these series of documents laid the platform for Government's commitment

to assist in increasing the financial security of all citizens by reforming the retirement funding industry and incentivizing non-retirement savings. During the same year, technical discussion paper D (National Treasury, 2012) was released for public comment and proposed the introduction of new tax-incentivised schemes that incorporated interest bearing and equity accounts to revitalise saving. The paper further proposed that the incentives should not be targeted or restrictive, such as education or welfare-based schemes as offered in other countries, but expansive and offer incentives that accommodate for any saving goals the investor requires. To ensure that the incentives are predominantly enjoyed by low- to middle-income investors and simultaneously protect the fiscus against portfolio shifting, annual and total investment contributions will be capped for natural person. Furthermore, to curb costs and complexities associated with financial products, tax free investment products should offer fair value with reasonable charges and clearly stipulate costs, risks and returns in a manner easily understood by the layman.

On 1 March 2015, section 12T of the Income Tax Act, (National Treasury, 2015), was promulgated and gave rise to a new tax-free investment vehicle for natural persons. All interest, capital gains, and dividends earned in a tax-free investment account are exempt from tax for investments of up to R30 000 per annum (R33 000 from 2017 tax year) and a lifetime limit of R500 000 per individual. If a portion of the annual limit is not utilised in any tax year, it is forfeited and cannot be carried over to successive years of assessment. Investments in excess of the annual limit will be penalised via a flat rate of forty percent of the amount over the limit. Where withdrawals are made from tax free accounts and then reinvested into similar accounts, such withdrawals are regarded as new investments and will impact the annual and lifetime limits. The annual and lifetime limits imply that these tax concessions are focused on low- to moderate-income groups and aims to facilitate a positive savings culture, thus laying the foundation for increased household savings and reducing the propensity for dipping into long-term retirement funds to settle short- to medium-term debt. This is also reinforced by prohibiting withdrawals from tax-free accounts to be reinvested without affecting annual and lifetime limits. Penalties on excess contributions provide a strong

deterrent for asset shifting from taxable to tax free accounts. Given the annual and lifetime limit, tax free investments should be considered as a long-term investment as the full benefits will only be achieved given an investment horizon of over fifteen years.

2.7 International Tax-incentivised Schemes

Several countries have introduced tax incentives to encourage saving either at a general level or at a more focused level such as education or housing (National Treasury, 2012). Such incentives may have two offsetting effects in that the incentives may encourage new savings in households that otherwise did not save, or it may result in asset reallocation by existing savers from taxed to incentivized schemes resulting in a loss to the fiscus. Hence, for policy to be effective, the amount of new saving must be sufficient to cover the revenue lost by Government. Furthermore, policy will be effective if it attracts a significant amount of low- to middle-income households as their tax rates are generally lower, thus minimizing revenue loss. The countries that were reviewed are generally developed countries that have implemented specific regulations to encourage additional savings amongst low- to middle- income groups and were considerable research has been conducted to examine the success of such reforms.

In 2007, the Organisation for Economic Co-operation and Development carried out a study on eleven member countries to determine the factors that affect and promote non-retirement saving to assist policymakers who wish to embark on such schemes for their respective countries (OECD Tax Policy Studies, 2007). Focus was placed on schemes that were designed to encourage non-retirement saving and saving for education. It was generally observed that the participation rates as well as the benefits accrued were higher amongst the higher-income rather than the low- to middle-income groups. Further observations were that the number of participants decreased as income increased implying that participation and awareness in the low to middle income groups were reasonable. However, the rate of participation as well as the average contribution increased with income.

In 1999, the United Kingdom introduced a tax preferred savings account known as the Individual Savings Account to encourage savings amongst low-income individuals. These schemes are similar to tax-free investments offered in South Africa in that they exempt interest, dividends and capital gains from tax. 15.4 million savers were subscribed to these saving accounts in the 2011 tax year with total investments amounting to £54 billion (National Treasury, 2012). More than half of the subscribers earned less than £20 000 per annum with only ten percent of subscribers falling into the high-income group leading policymakers to believe that their initiatives were successful in improving savings amongst lower income groups. However, research conducted by Donnelly and Young (2012) suggested that Individual Saving Accounts are not as successful as touted. Only one out of three investors are from lower income groups and the participation rate only rises to fifty percent at much higher income levels. Furthermore, individuals with higher income make larger contributions. Hence, these accounts do not significantly encourage savings at low income levels. Of the one-third in the low-income group that did invest, less than five percent would have accounted for new savings as the remainder would have saved in other products anyway. Another observation was that Individual Saving Accounts have done little to alleviate the barriers to saving faced by low income groups such as the lack of disposable income, mistrust of the financial sector and confusion and misunderstanding with respect to investment products. Over time participation decreases in low income groups but grows in high income groups. The authors concluded that the typical account holder is male, belongs to the highest-income cohort, and is approaching retirement. (Donnelly & Young, 2012, p. 372).

In a Canadian study by Alarie (2009), tax-prepaid investments were compared to tax-postpaid investments such as retirement savings. Tax-prepaid accounts are funded by contributions that are not tax deductible whereas contributions to retirement plans are tax deductible upfront in the respective year of assessment. The author argues that household savings are not responsive to tax incentives and that adjustments to tax-postpaid instruments would have achieved superior results as compared to tax-free investments.

A further study of Canada's tax incentivised saving scheme conducted by Kesselman (2015) provided a critical analysis on the success of tax-free saving accounts and examined the benefits of increasing the contribution limit from \$5 500 to \$10 000 as per the 2015 budget. Although there was fairly widespread participation in these accounts since inception in 2009, participation has begun to tilt towards the wealthy in successive years and will continue to do so at a steeper rate. Furthermore, investment choice has shifted from low risk saving schemes to higher risk equity-based schemes. The author compared the maximization and participation rates over a five-year period from 2009 to 2013 whereby the participation rate is the percentage of eligible Canadians who are tax free account holders and the maximization rate is the percentage among the relevant group who had fully utilized their cumulative tax-free limits in the respective year. It was observed that the maximization rate declined sharply over the period from sixty-four percent to seventeen percent and two possible explanations were hypothesized. Firstly, the rate had reduced because no new saving was utilized to fund tax-free accounts and former saving, which had subsequently exhausted, was merely diverted from existing accounts. If new saving out of current income was utilised, then the maximization rates would have increased. The alternative was that investors in successive years had fewer assets to shift or had less income to save. The author concluded that the first hypothesis was more plausible considering that the participation grew while the maximization rate fell simultaneously. Furthermore, it was also noted that all age groups maximised their accounts in 2009 but these rates fell most sharply amongst the younger age groups by 2013. This provided further evidence of assets being shifted and subsequently exhausted rather than new saving being used to finance tax-free accounts because older people have accumulated more assets which they are capable of shifting when compared to young investors. A sharp decline in the amount invested was also noted in lower income groups when compared to higher income groups indicating that the wealthy are more likely to benefit from an increase in the contribution limit. Furthermore, further evidence showed that families with higher total income were able to reap a greater benefit via intra-family income splitting and asset shifting.

2.9 Current analysis of tax-free investments

As referenced below, several articles have been written and research conducted regarding the impact of tax-free investments since its inception in South Africa. This section will address the advantages and disadvantages of these investments, contrast them to other investment products, and evaluate its ability to improve household savings.

Research into the uptake of tax-free accounts has been conducted by Intellidex (2017). The company has surveyed the majority of providers of tax-free products including banks, stockbrokers, asset managers and life insurers. The main goal of the researchers was to determine the impact of tax-free products on the savings behavior of South Africans. Since inception in March 2015, approximately 480 000 tax-free accounts were opened with a total asset base amounting to R5.174 billion or an average of R11 251 per account. Banks were found to be the dominant market player followed by life insurance companies.

2.9.1 Asset Shifting

During the tax year ending February 2017, only 13% of accounts were opened by first-time savers in contrast to 21% in the previous year. Hence, the researchers believe that the accounts do have a reasonable effect in galvanising people to become savers (Intellidex, 2017, p. 3). However, the decrease in new accounts could indicate that interest is declining or that previous accounts were opened with money that would otherwise have been invested in traditional products and, which now, is depleted. Hence, new funding was relatively low and asset shifting could have been the predominant driver. For tax policy to be effective, funding into tax-free accounts need to come from reduced consumption and cannot be gauged by participation rates alone. Similar trends were observed in international studies (Attanasio, et al., 2004); (Alarie, 2009); (Donnelly & Young, 2012); (Kesselman, 2015).

2.9.2 Pre-existing Incentive

The key objective of introducing tax-free schemes is to promote household savings and thereby reduce the vulnerability of households (National Treasury, 2012). The traditional mechanism is an interest exemption of R23 800 per annum on interest income which was not considered to be “highly visible” by National Treasury (2012, p. 6). Government does not intend to increase this exemption in line with inflation thereby eroding its value over time, allowing investors to rearrange their affairs and to increase the viability of tax-free investments over time. However, Leonard (2017) considers that the current interest exemption is sufficient to promote savings. Tax-free investments are appropriate as long-term investments and one would only benefit from these accounts if the value of the investment exceeds the interest exemption and capital gains exclusion. For example, if one invests in an interest-bearing fund earning a rate of 6% per annum, the fund would have to be worth R396,667 before the interest exemption is exceeded. Such a capital value for many low- to middle-income savers is surely adequate to protect themselves from financial vulnerability. Furthermore, given an annual exclusion of R40 000 on capital gains, an investment with strong capital growth would potentially exceed the capital exemption only after 5 years. Hence, tax-free investments do not provide any added relief to consumers who may require short- to medium-term cash funds. This conclusion was also reiterated by Fisher-French (2016) who emphasised that tax-free accounts should not be used for emergency savings because such accounts are simple and more accessible long-term investments for people who want to supplement their retirement savings. The researcher analysed studies conducted by a prominent insurance company and observed that 66% of respondents were using tax-free investments for emergency savings and 60% of respondents invested in cash accounts. Hence, the purpose of tax-free accounts was not understood and defeated. Results from the Intellidex survey (2017) also raised concerns that 47% of accounts were invested in cash and that, given the low interest environment, real rates of return would be low or even negative.

2.9.3 Demographic uptake

International studies conducted by the Organisation for Economic Co-operation and Development (OECD Tax Policy Studies, 2007), Donnelly and Young (2012) and Kesselman (2015) noted that participations rates were skewed towards high-income groups, provided little relief to alleviate the barriers to saving and did not significantly encourage savings in the low-income groups. Similar findings were revealed in the Intellidex survey (2017), where it was noted that more middle- to upper-income groups were capitalising on the opportunity. Only 8.1% of account holders have utilised the full annual limits since inception indicating that the annual contribution limits are not a hindrance to low-income groups but conversely indicate that they may not have the necessary income to maximise their annual limits. Further negative commentary was also observed when the sentiment of life insurance companies during the 2016 survey revealed that tax-free products would not have a very positive impact in promoting a savings culture (Intellidex, 2016). Visser (2018) also reports that tax-exempt investments have not enticed the low-income taxpayer and that policy attempt has not been matched by the tax reality.

2.9.4 Tax-free savings vs Retirement Products

An article published in Finweek (Visser, 2018) compares the benefits of investing in a retirement annuity over a tax-free investment. Both investment vehicles are long term and are exempt from income and capital gains tax. However, retirement annuity contributions are tax deductible annually whereas contributions to tax-free investments are not. Any annuity payments made from retirement funds during retirement years will be taxed at the investor's annual marginal rate, which will generally be lower than that when fully employed. Withdrawals from tax-free investments will be completely exempt from tax. Access to funds in a retirement annuity is very restricted when compared to tax-free investments. However, although tax-free accounts are liquid, their benefits can only be achieved over a long-term horizon as regular cash withdrawals cannot be replaced due to annual and lifetime contribution caps. Hence, the investor needs to determine the purpose of the investment to ascertain which vehicle is most appropriate. Either way, tax-

free investments should not be utilised as a normal transactional account for short-term savings given that an interest exemption already exists for such products. As a rule of thumb, investors should maximise their contributions to a retirement annuity, pay of all debts and then invest in a tax-free account. Marais (2016) utilised the marginal tax rate of an investor to determine the most tax-efficient investment. He recommended that if the tax rate paid while saving exceeds that of the tax rate paid on withdrawal, the investor would have a comparative advantage. Hence, investors with a high marginal tax rate should maximise their retirement annuity contributions first before investing in a tax-free account. Investors on a low marginal tax rate should maximise their contributions to a tax-free investment first as there is a large probability that their future marginal rates would be higher. Hence, tax-free investments serve as an important tax efficient savings vehicle for lower- to middle-income investors given that a long-term outlook is maintained.

2.9.5 Other criticism

One respondent bank from the Intellidex survey (2017) stated that the lifetime limit of R500 000 could be a barrier to entry for tax-free accounts as this limit will reduce should investors wish to access their cash prematurely as any withdrawals cannot be replenished without attracting tax. Individual Saving Accounts in the United Kingdom do not have lifetime limits and thus attracts liquid cash. Many respondents also requested for strong educational and marketing campaigns around tax-free products, especially from government and the financial industry. Many investors do not know the difference between tax-free savings and tax-free investments. The former is cash based and, given low interest rates, will offer inferior results to investment-type accounts which are equity based and yield higher real returns.

2.10 Chapter Summary

This chapter has highlighted the importance of household savings as a means to improve economic prosperity at local and national levels. Savings in South Africa must be driven by reduced consumption notwithstanding high levels of poverty, debt and unemployment. Tax-free investments have been introduced to lure

investors to increase their net savings but researchers remain skeptical as to whether the product in its current form can significantly achieve this. The next chapter will discuss the research methodologies utilised to gauge an opinion of the preceding ambiguity.

CHAPTER THREE

Research Methodology

3.1 Introduction

This chapter describes the research methodology used to obtain data that would provide insight into the research problems revealed in Chapter One. The research philosophy and design are presented followed by data collection strategies and tools that would ensure valid and reliable results.

3.2 Research Paradigm

This study was conducted under the ambit of a positivist paradigm where a researcher would emphasise quantifiable observations that lend themselves to statistical analysis (Saunders *et al.*, 2007). Research begins with theory followed by data collection which is used to support or refute the theory. Furthermore, this study has adopted a quantitative research design as positivist paradigms generally lend themselves to quantitative research (Kumar, 2011). This study begins with a literature review that examines the theoretical factors that influence consumption and saving and the impact of tax-incentivised saving schemes on consumer behaviour. Data from a survey is then consolidated and analysed to provide an opinion on the theoretical framework. This ensure consistency with quantitative research designs.

3.3 Research Design

A research design is the overall strategy that the researcher adopts to integrate the different components of the study so as to effectively address the research problem and may be exploratory, descriptive or causal in nature (Sekaran & Bougie, 2013). According to Kumar (2011), descriptive studies attempt to systematically describe a phenomenon via the collection of data pertaining to that phenomenon. This study will be descriptive in nature in that it consolidates information obtained from a survey to evaluate the factors that lead to poor saving

followed by an analysis to determine the influence of tax-free investments on savings behaviour.

A quantitative research design is ideal if the researcher wants to quantify a variation in a phenomenon and if the analysis is geared to ascertain the magnitude of the variation. This design is also useful if the researcher attempts to identify factors that influence an outcome or attempts to uncover the best predictor of outcomes (Creswell, 2013). This study is based on a quantitative design because it has attempted to identify the theoretical factors that influence household saving and to predict the magnitude of change that tax-free investments will have on saving.

3.4 Research Strategy

The distinction between data collection methods used for quantitative or qualitative research depends on the restrictions imposed on the researcher in terms of flexibility and freedom used during the research process (Kumar, 2011). Quantitative methods are more restrictive than qualitative methods. Furthermore, quantitative data collection techniques predominantly generate numerical data for analysis in contrast to qualitative techniques that generate non-numerical data (Saunders *et al.*, 2007). This study is quantitative and utilises a mono method collection technique. The single data collection technique used is a survey and the ensuing responses form the basis of analytical procedures. The survey solicits the opinions of respondents about the factors that affect saving and their views on tax-free investments and the corresponding analysis that is generated from the responses contextualises the significance of these variables to the South African environment.

3.5 Research Setting

The research was conducted in Durban, South Africa. Questionnaires were dispensed to financial advisors of an insurance company and duly completed and collected at their office premises. This was a cross-sectional study as questionnaires were administered once and responses gathered over a period of 3 weeks.

3.6 The Target Population

Insurance companies are the second largest service providers of tax-free products after banks (Intellidex, 2016). Hence, the group surveyed for this study consisted of financial advisors from an insurance company in Durban as they had the prerequisite knowledge and experience to formulate an opinion. Apart from tax-free products they, depending on the size of their client base, are likely to have a unique insight into the demographic and economic factors that affect consumers in South Africa. No sampling techniques were conducted as the entire team of 110 consultants were surveyed. The population included consultants at all levels from academy advisors to senior and regional advisors. All levels of education and years of experience were also incorporated. Hence, sampling bias was reduced and the population is likely to produce reliable results.

3.7 The Research Instrument

Research instruments measure the variables that are being studied and any tools used to produce findings or conclusions must prove to be valid and reliable (Sekaran & Bougie, 2013). This study used a questionnaire as a research instrument. Questionnaires facilitate the collection of large amounts of quantitative data and are appropriate for descriptive studies (Sekaran & Bougie, 2013).

3.7.1 Survey Instrument Design

A questionnaire was developed and the Likert Scale was used to measure the respondent's opinions or attitudes. A 5-point scale was used ranging from strongly agree, agree, neutral, disagree to strongly disagree. The first part of the survey recorded demographic information about the respondents. The next part sought their opinions on savings with reference to theoretical models of saving and consumption. Thereafter, respondents were requested to rank demographic and macroeconomic factors that would affect saving from a score of 1 to 5 where a score of 5 would have the strongest influence and a score of 1 would have the least. The last part of the survey solicited respondent's opinions with respect to tax-free investments and other financial products. The questionnaire would have

taken no longer than 15 minutes to complete to ensure respondents do not lose interest and that responses are maximised.

The questions were designed to elicit responses that would assist in answering specific research questions as follows:

- Question 1 to 5 provided demographic information about the respondents
- Questions 6 to 9 revolved around the theoretical factors that affect savings and assessed the respondent's predilection to these socio-economic variables as a component of current savings behaviour
- Question 10 asked the respondents to choose the most pertinent demographic variable that affects current savings. The variables included financial education, race or cultural habits, age, disposable income and dependency on others. Each variable had to be ranked in order of importance ranging from 1 to 5 where a 5 would indicate the greatest importance and 1 the least
- Question 11 asked the respondents to choose the most pertinent macroeconomic variable that affects current savings. The variables included economic growth, unemployment, inflation, debt and tax incentives. Each variable had to be ranked in order of importance ranging from 1 to 5 where a 5 would indicate the greatest importance and 1 the least
- Questions 12, 13 and 14 asked respondents to express their opinions on who they considered to be the ultimate beneficiaries of tax-free investments with respect to income groups, traditional savers and those with barriers to saving. The intention here is to determine if there is a correlation between international observations and local behaviour and

thus assess whether the pitfalls experience internationally would have a similar detrimental effect on local reforms

- Question 15, 16, 17, 18, 19, 21 and 24 revolve around the characteristics of tax-free investments and attempts to determine whether they are primed to stimulate new investment in the opinion of the respondents
- Questions 20, 22, 23 and 25 attempts to elicit whether the new reforms have been adequately promoted to the extent that they have revitalised new savings

3.7.2 Data Collection

Questionnaires were personally distributed to the regional secretariat who then distributed them to the different departments. This reduced bias as no explanations or information were given to different groups of respondents. This was a cross-sectional study as opposed to a longitudinal study. Cross-sectional studies are conducted within a predetermined time frame while longitudinal studies collect data at more than one point in time (Sekaran & Bougie, 2013). Questionnaires were dispensed once and responses collected over a period of 3 weeks at regular intervals.

3.8 Data Analysis

Data was obtained from 77 questionnaires that were completed. The data was then checked and analysed for outliers and incomplete information and transferred to statistical analysis programs.

3.8.1 Analysing and Interpreting Quantitative Data

After obtaining completed questionnaires, data was coded into an Excel spreadsheet. Demographic information about respondents were coded from 1 to 5 and ran from left to right in ascending order. For Likert scale questions, the coding ranged from 1 to 5 where 1 denoted a strong agreement and 5 denoted a strong

disagreement. Non-responses were coded as 99. For questions that required respondents to rank a variable from 1 to 5, the actual number chosen was used for coding. Once data was coded, it was imported into IBM's SPSS statistical analysis program where various exploratory reports were generated. Positively based question were re-coded in SPSS so that scores were reversed to calculate the mean. Frequencies and means were calculated per question to analyse responses and generate graphs.

3.9 Validity

According to Sekaran and Bougie (2013), validity tests how well the instrument measures the concept it is intended to measure. Validity tests used to test the goodness of measure are broadly divided into content validity, criterion-related validity and construct validity.

Content validity requires that an adequate and representative set of items are utilised to measure a concept. The questionnaire utilised in this study contained numerous questions that solicited responses to factors that affect saving and respondent's impressions over tax-free investments. These opinions would be adequate for the researcher to formulate an opinion on the impact of tax-free investments on household saving in South Africa, which is the focus of this study.

Criterion-related validity can be obtained when the research instrument used is similar to that of other instruments used in similar research. Questions used by the researcher were similar in content to other questionnaires that investigated the factors that influence saving.

Construct validity is a measure of whether the instrument actually measures the topic of research. The content of the questionnaire in this study emanated from the literature review as well as questions used by other researchers studying a similar topic.

3.10 Reliability

Reliability refers to the degree to which the results obtained by a measurement and procedure can be replicated (Bolarinwa, 2015). The questions posed in the questionnaire were directly referenced to tax-free investments.

3.11 Elimination of Bias

3.11.1 Researcher Bias

Researcher bias may be introduced when questionnaires are personally administered by the researcher as the researcher may unwittingly provide different explanations to different groups when contextualising the purpose or content (Sekaran & Bougie, 2013). During this study, the researcher dropped off the questionnaires at a central point and did not engage with the participants. The covering page to the questionnaire explains the purpose and content of the study.

3.11.2 Selection Sampling Bias

Selection sampling bias may occur where the researcher excludes certain groups from the study leading to a skewed sample which is not a fair representation of the population. This was avoided in this study as the entire population of financial consultants at the relevant insurance office was selected.

3.11.3 Response Bias

Response bias is a tendency for participants to respond inaccurately and often occurs where questions are not written correctly. This was minimised by asking short and clear questions, avoiding the use of loaded questions, using interval questions and utilising a sample with adequate knowledge on the subject.

3.12 Ethical Stance and Consideration

The gatekeeper's letter was obtained from the area manager of the insurance company surveyed and is shown in Appendix C. Thereafter, ethical approval for this research was obtained from the University of Kwa-Zulu Natal as shown in Appendix A. The covering page of the questionnaire assured participants that their

involvement was completely voluntary and that confidentiality and anonymity of records will be maintained as per University policy. No personal information of the respondents were requested.

3.13 Chapter Summary

This study was conducted under the realm of a positivist paradigm and adopted a quantitative methodology of research. A survey, confirming to ethical requirements, was administered using a questionnaire as the research tool from which responses were captured on a statistical program for further analysis as described in Chapter Four.

CHAPTER FOUR

Presentation and Analysis of Results

4.1 Introduction

The previous chapter highlighted the research methodologies adopted to ensure the validity and reliability of the data presented henceforth. This section will present data in the form of descriptive statistics. An analysis of the demographic attributes of the participants will be presented followed by their opinions on socio-economic factors that affect savings. Finally, opinions with respect to tax-free investments will be examined.

4.2 Demographic Analysis of Participants

This section summarises the demographic characteristics of the participants and focusses on their experience, education and job profile in the insurance industry. Two further questions establish the size of their client base and the approximate annual income of their clients which may indicate the degree of exposure to different saving products. Respondents were employees of an insurance company in Durban.

The figure below depicts the experience of the respondents.

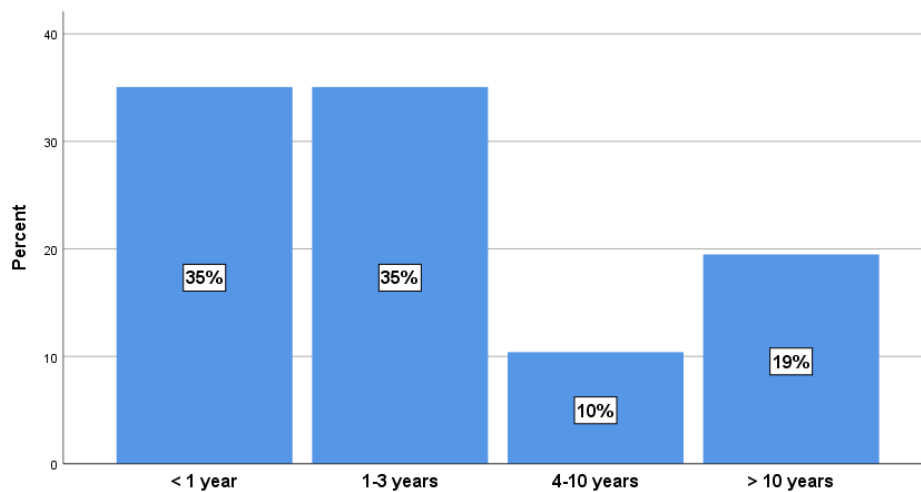


Figure 4.1 Experience of Participants

Most respondents (70%) have less than 3 years of experience and can be considered as junior financial consultants by way of experience. However, these participants would either be within or graduated from the organisation's training academy, thus giving them exposure to new products such as tax-free investments. Approximately 20% of respondents are highly skilled as their experience in the industry exceeds 10 years.

The graph below represents the highest educational qualification of the respondents.

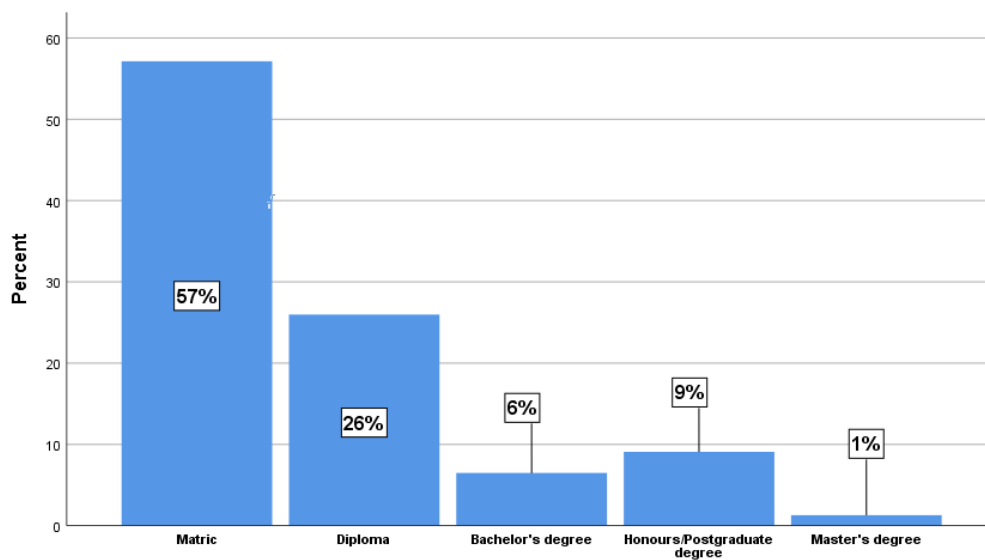


Figure 4.2 Highest Level of Education

Over 50% of the respondents did not possess any post-matriculation qualification. However, training in financial literacy is provided by the employer and is compulsory if respondents wish to pursue their careers further. 41% of respondents possessed a post-matriculation qualification.

The graph below depicts the job profiles of the respondents.

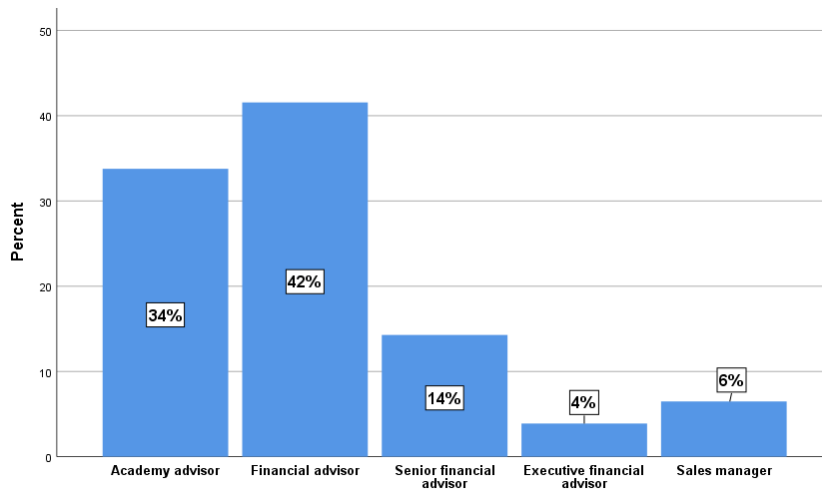


Figure 4.3 Occupational Role

Almost one-third of the respondents are junior advisors that are undergoing on the job training at the company's training academy. As such, they are exposed to new saving products including tax-free investments. The remaining respondents occupy qualified positions and widely exposed to all saving products. 10% of respondents occupy senior management roles at the company.

The figure below depicts the average size of a consultant's clients base

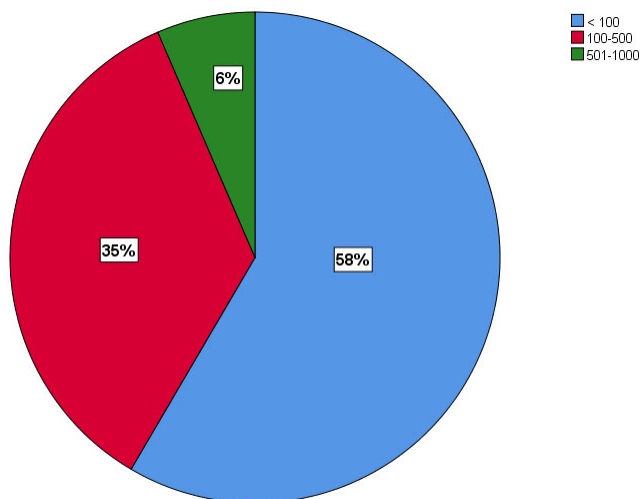


Figure 4.4 Size of Client Base

The majority of respondents have a relatively small client base which would be expected given that 35% of all respondents have less than 1 year of experience. However, 41% of respondents have a client base in excess of 100 and therefore well exposed to trends in the industry. These respondents will be suitably exposed to the spending and consumption patterns of clients given that consultants need to conduct an affordability analysis before selling any financial products.

The figure below depicts the average annual income of clients that utilises the services of the respondents.

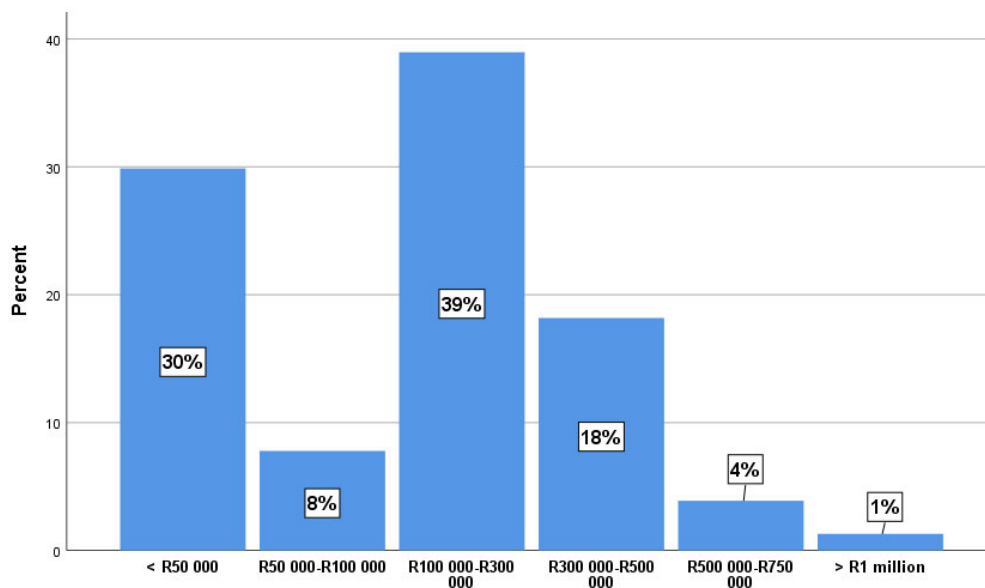


Figure 4.5 Average Annual Income of Clients

As income is a necessity for investment, the above graph analyses the distribution of average annual income of clients. At the lower end of the income spectrum 38% of clients earn less than R100 000 per annum and would suggest low disposable income available for investment. The majority of clients (57%) are middle-income earners and, given prudent financial management, would have adequate disposable income for investment and, therefore, require the services of the respondents.

4.3 Presentation of results

The questionnaire was divided into 3 sections and solicited the respondent's opinions on factors that affect savings, variables that are most likely to induce savings and their opinions on tax-free investments.

4.3.1 Factors that affect saving

The figure below depicts the factors that the respondents consider most likely to affect the level of household saving. The variables include disposable income, income stability and consumption habits.

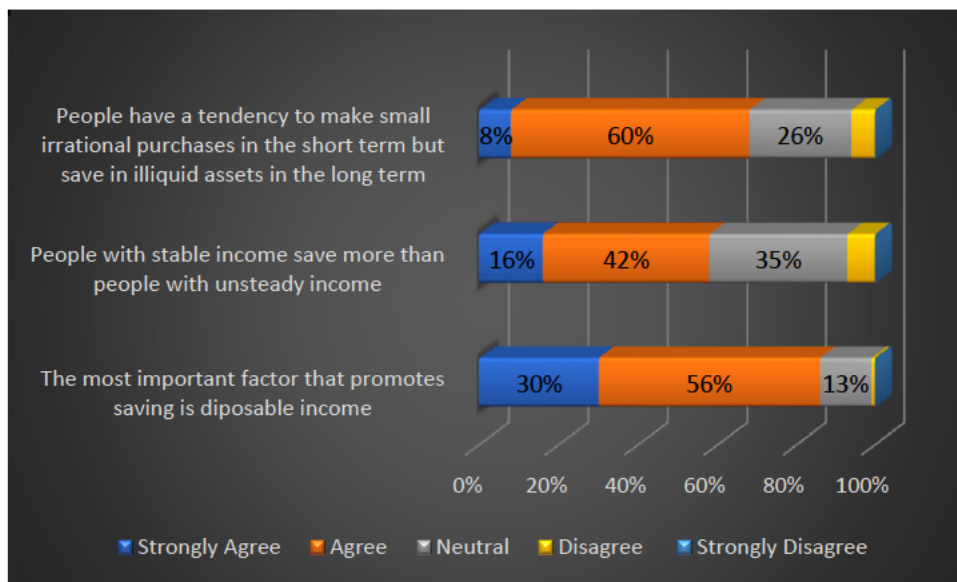


Figure 4.6 Factors that Affect Household Saving

An overwhelming proportion of respondents considered income to be the key variable that affects savings. Furthermore, most respondents agree that a steady income source is vital for saving and that consumers display irrational consumption patterns in the short term but invest the rest of disposable income in long term fixed assets.

The figure below indicates the predominant age group that saves.

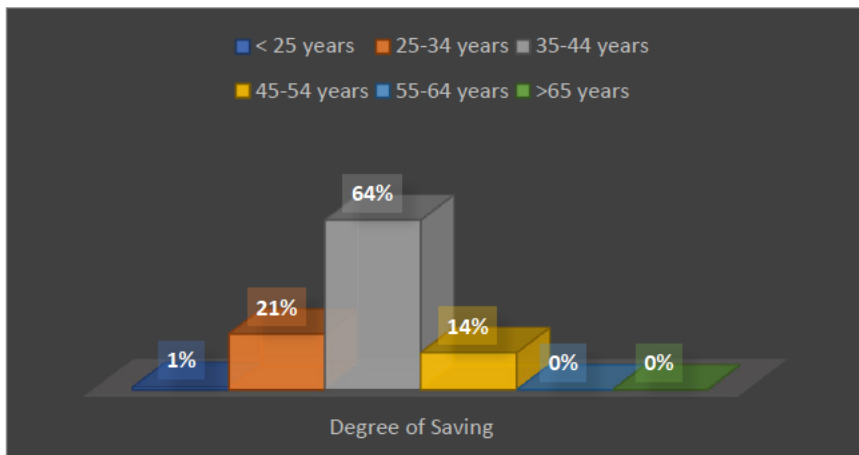


Figure 4.7 Predominant Age Group that Saves

Most respondents indicated that savings are predominantly discharged by middle-aged investors ranging from 35 to 44 years followed by younger investors. The respondents believe that no saving occurs beyond the age of 55 years.

4.3.2 Demographic factors that impact saving

This section analyses demographic variables that have an impact on household savings in South Africa. The factors include the level of financial education, national savings culture, age of consumer, the amount of disposable income and the dependency of the consumer on others. The results are depicted in the figure below.

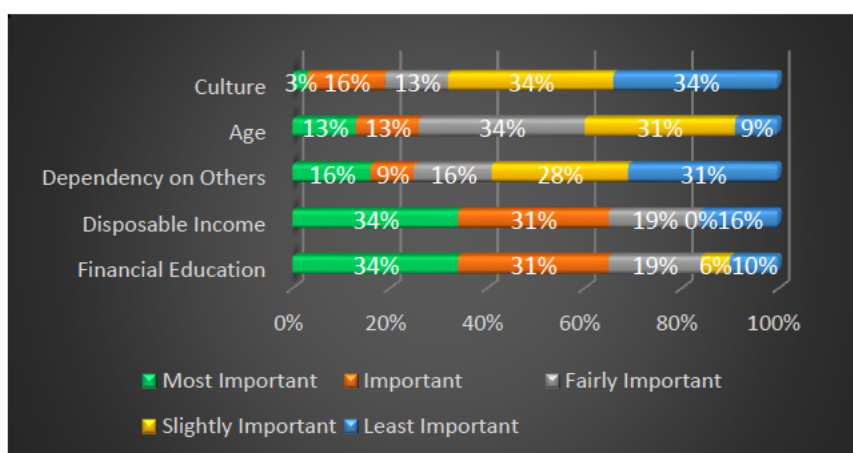


Figure 4.8 Demographic Factors that Impact Saving

Financial education and income have both received similar ratings in terms of their level of importance and are therefore considered to be vital constituents of savings. Dependency and culture are considered to be of least importance.

4.3.3 Macroeconomic factors that will stimulate savings

This section analyses the macroeconomic factors that could stimulate additional savings amongst consumers. The variables examined are improved economic growth, reducing unemployment, reducing inflation, reducing debt and increasing tax incentives that propagate savings. The survey results are depicted below.

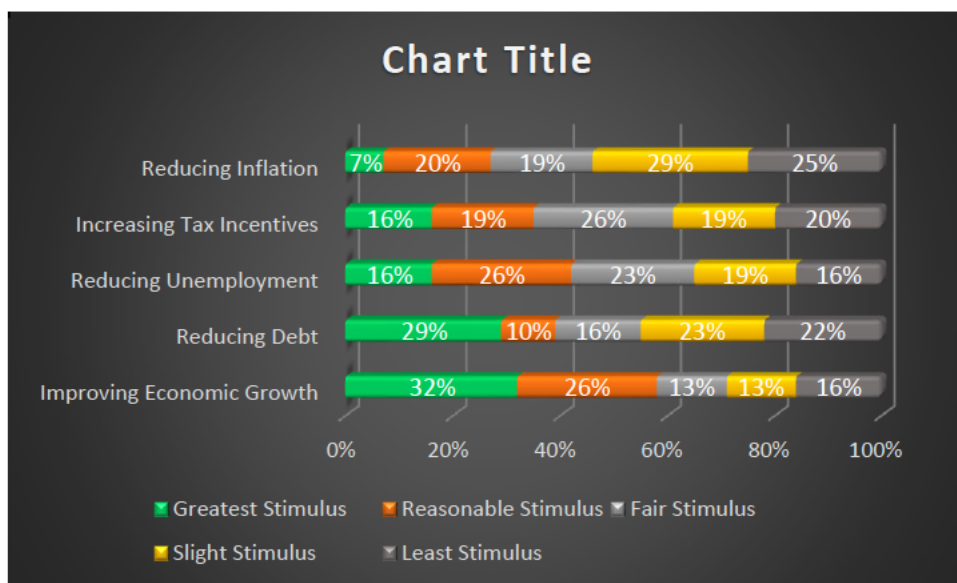


Figure 4.9 Macroeconomic Factors that Stimulate Saving

The survey results indicate that improving economic growth is paramount to stimulate an increase in savings followed by the reduction of debt. The next vital factor is the reduction of unemployment and collectively these three variables determine levels of income. This corroborates the importance of income observed in the previous section. Reduction of unemployment and increasing tax incentives share similar levels of importance whereas the reduction of inflation is the least important factor.

4.3.4 Opinions on tax-free investment products

The participants were asked a series of questions on tax-free products using a five-point Likert Scale. The scale ranged from 1 – Strongly Agree, 2 – Agree, 3 – Neutral, 4 – Disagree and 5 – Strongly Disagree. For positive questions, scores were reverse-coded in SPSS data editor. According to the scale used, the mean was 3 for all possible answers. Hence, answers that scored in excess of 3 indicated that respondents had a positive perception of the scale item while a score below 3 indicated that they had a negative perception. The table below indicates the average responses per question

Table 4.1 Average Responses to Questions on Tax-free Investments

	N	Mean
Beneficiaries of Tax-incentivised Products		2,99
Tax-free investments have encouraged new and additional savings as opposed to old savings being redirected to tax-incentivised accounts	77	3,81
Tax incentivised saving schemes will do little to break down the barriers to saving faced by low income groups. (Barriers to saving include little or no income, lack of financial education, no access to financial products, etc.)	77	2,38
The wealthiest will benefit the most from tax-free investments	77	2,79
Comparison to Traditional Investments		2,80
Contributions to retirement funds are more likely to induce additional savings as they are tax deductible upfront	77	2,05
The pre-existing interest exemption of R23 800 per annum for persons under 65 years is sufficient to incentivise savings	77	3,04
I am incentivised to sell tax free savings and investment products	77	3,3
Marketing		3,28
The government has implemented a robust educational program to create an awareness around the importance of saving	77	3,03
I have received an increasing number of queries regarding tax-free investments over the last year	77	3,3
My clients are aware of the risks and costs associated with the different types of tax-free investment products	77	3,82
Interest in tax free investments are declining	77	2,96

The questions were divided into three subsections that revolved around the consumers of tax-free products, their comparison to traditional investment products and the promotion thereof by government and business sectors. The preceding table presents a holistic view of opinions on tax-free products and the mean scores per scale item. Further analysis is provided below in terms of each subdivision.

The respondents were solicited to answers questions around the beneficiaries of tax-free products since its introduction as the literature review revealed that upper-income groups generally benefited and that new investments were driven by tax arbitrage. The graph below depicts the results of the survey with respect to the consumers of tax-free products.

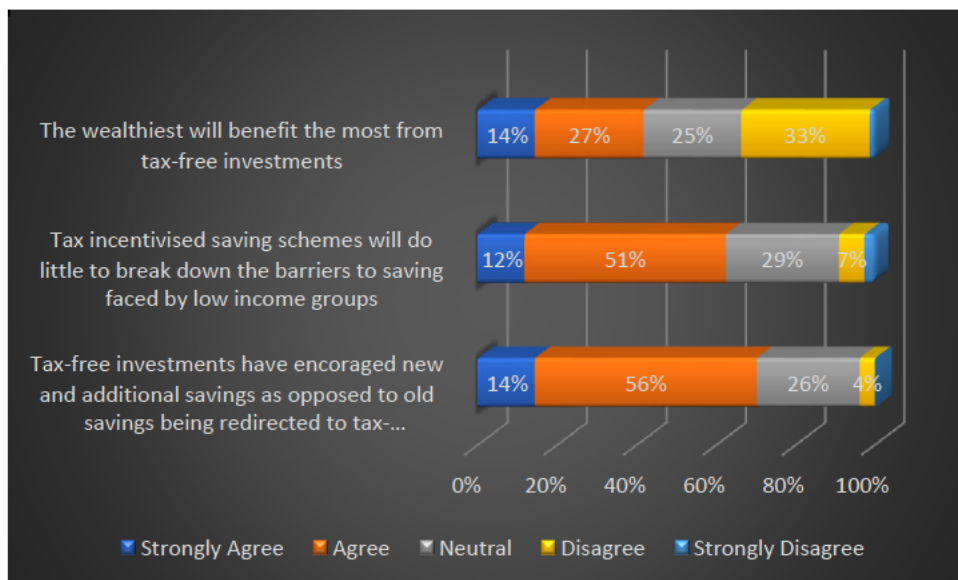


Figure 4.10 Consumers of Tax-free Products

70% of respondents believe that the introduction of tax-free products have managed to procure fresh investments as opposed to old investments being redirected into more tax-efficient accounts. However, low-income groups are still faced with barriers to saving such as low disposable income, poor financial education and low access to financial products. Hence, tax-free products may not be able to solicit new investment from low-income groups. Furthermore, 41% of respondents believe that higher-income groups will reap the greatest benefits in

contrast to 34% who believe otherwise. This provides further evidence that tax-free investments may not be able to penetrate the low-income investment market.

The graph below compares the uptake of tax-free investments to traditional products such as retirement annuities and money market accounts. Retirement products are long-term investments that have strict withdrawal rules and are generally only accessible upon retirement. Money market accounts are geared for short-term savings and are highly liquid.

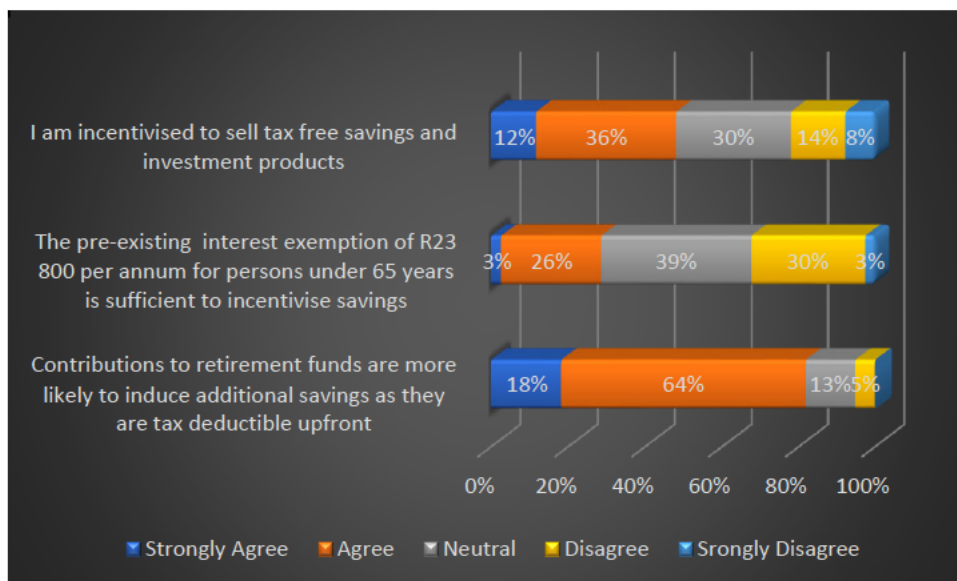


Figure 4.11 Comparison to Traditional Financial Products

Most respondents have agreed that retirement funding is more likely to induce savings as contributions to these funds are tax deductible in the year of contribution. Contributions to tax-free products are not deductible upfront and need to be financed from post-tax income giving rise to cash flow drawbacks. In the next question, respondents were asked to concur whether the pre-existing tax exemption is sufficient to induce savings despite the introduction of tax-free products. The results were divided at either end whereby 29% of respondents believed that they were sufficient while 33% believed that they were not. Surprisingly, most respondents took a neutral stance indicating a large degree of uncertainty and a potential dimension for further study. 48% of respondents were incentivised to sell tax-free products while a significant portion remained neutral indicating a noteworthy cause for concern.

The preceding concerns were analysed further to determine which group of the population, as stratified by years of experience, had divergent views. The results with respect to pre-existing interest exemptions are depicted in the table below.

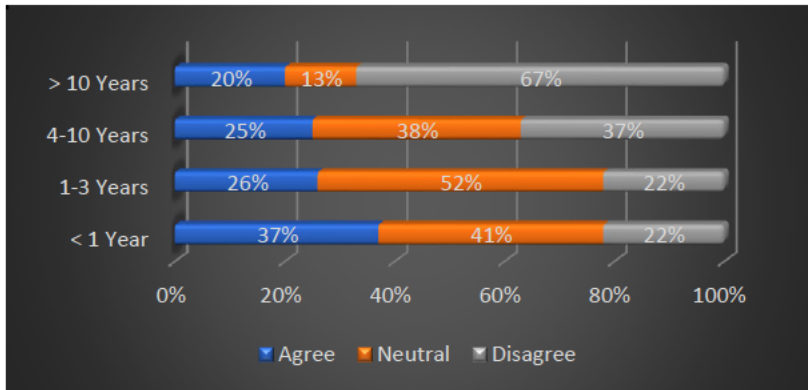


Figure 4.12 Adequacy of Pre-existing Interest Exemption Stratified by Experience

It is evident from the above figure that opinions on the adequacy of pre-existing tax exemptions differ at different levels of work experience. Less experienced respondents are either, generally in agreement or uncertain. Respondents with greater experience do not believe that the pre-existing exemption is adequate to stimulate new savings, especially those with over 10 years of experience.

The figure below reflects the diversity of respondents with respect to sales incentives.

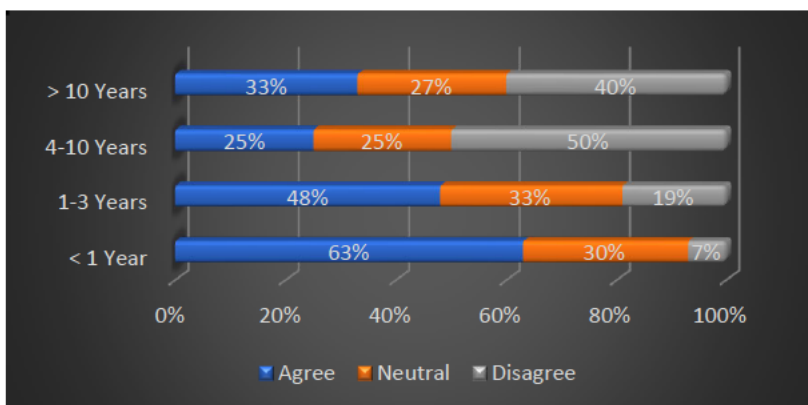


Figure 4.13 Adequacy of Sales Incentives Stratified by Experience

The preceding figure also reflects a degree of diversity between the different groups. The less experienced population believe that they are adequately incentivised. More experienced consultants believe that they are not adequately incentivised and probably receive greater financial rewards from selling traditional savings products. Hence, experienced consultants may be tempted to sell more traditional products to clients over tax-free products because of greater personal financial gain.

The figure below depicts an analysis of how well tax-free investments have been promoted since inception in 2015.

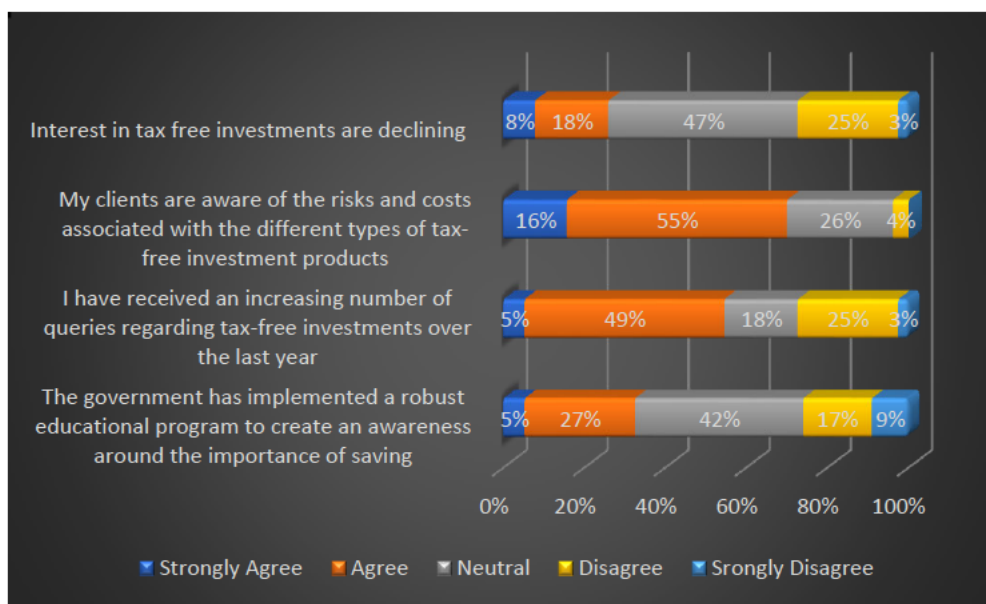


Figure 4.14 Promotion of Tax-free Products

Only 32% of respondents believe that government has adequately marketed the release of tax-free products to the public. Furthermore, 42% are unclear. This does not bode well for a government-initiated program that is trying to penetrate the mass population. Most respondents have indicated that they are receiving an increasing number of queries regarding tax-free products and that their clients are aware of the risks and benefits associated with these products. Finally, a large proportion of respondents seem unclear as to which direction tax-free investments will take within the scope of the investment world as they have remained neutral when questioned on the bearing of public interest over tax-free products.

The figure below reflects responses as to the nature and characteristics of tax-free products.

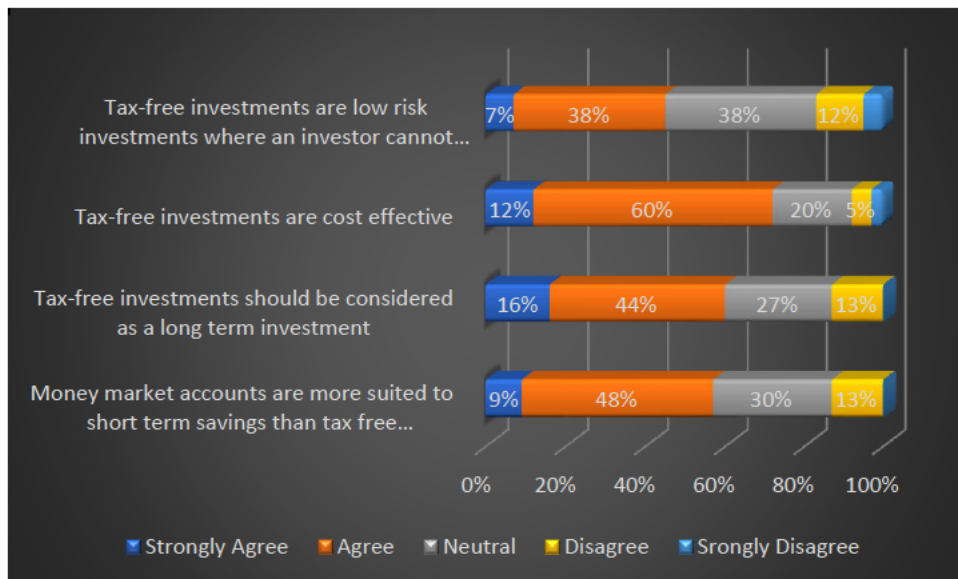


Figure 4.15 Nature of Tax-free Investments

Most respondents agree that money market accounts are the choice investment vehicle when short-term savings are a priority and that tax-free investments should be categorised as a long-term. Furthermore, these products are cost effective and, depending on investment product chosen, do have an element of risk attached as cited by 45% of respondents. 38% of respondents were unclear as to the risk attached to these products which signals that further exposure and product education is required.

4.4 Chapter summary

This chapter has presented the data obtained from the survey results in the form of descriptive statistics. The next chapter will provide a comprehensive discussion of the research findings in relation to observations discussed in the literature review.

CHAPTER FIVE

Discussion Conclusion and Recommendations

5.1 Introduction

This chapter will discuss the results of the survey in relation to the literature review conducted and the research questions posed. The aim is to ascertain whether the results are consistent with other research observations and to critically analyse and shed new insight to tax-free investment.

5.2 Research Objectives

The promulgation of tax-free investments in 2015 ratified Government's intent to improve household savings in South Africa via the tax system. For policy to be considered successful the following goals were pursued (National Treasury, 2012):

- Savings should be boosted via the tax system so as to strengthen resilience to income and expenditure shocks, particularly amongst low to moderate-income groups.
- Policy changes should foster a positive savings culture in the long term, reduce reliance on credit to fund consumption and ensure that short term fiscal losses incurred are compensated by future expected benefits. In this regard, low- to moderate-income groups should be the primary benefactors with some participation and asset shifting amongst higher income groups.
- Policy should address behavioural economic factors which suggest consumers lack self-control and are biased towards current consumption by increasing visibility through educational campaigns that improve financial literacy and savings culture.

- Tax-incentivised products should be cost effective with reasonable risk and return to investors.

Consequently, this study and the survey conducted set out to test whether the above criteria have been met since the induction of tax-free investments. The participants chosen in this study are financial consultants in the insurance industry and are key role players in the provision of investment advice to clients. They would therefore provide a unique insight into whether the goals of policy have been met. In particular, the research is aimed to achieve the following objectives:

1. To evaluate behavioural, demographic and economic factors that affect household savings in South Africa.
2. To determine how successfully tax-free investments have been implemented in South Africa.
3. To critically analyse the scope of the legislation and ramifications on household savings.

The remainder of the Chapter will contextualise the results of the survey in relation to the literature review and the research objectives.

5.3 Behavioural Factors that Affect Savings

The first part of the questionnaire assessed the relevance of theoretical consumption models to consumer behaviours as observed in the work environment of the participants. The theoretical models probed the link between income, income stability and consumption patterns to the levels of saving adopted.

Most respondents agreed that there is a positive correlation between income and the degree of savings undertaken. These results are consistent with Keynes's General Theory (Janse van Rensburg *et al.*, 2011) which states that savings will increase, albeit at a smaller rate, in proportion to increases in income.

The Permanent Income Hypothesis advanced by Milton Friedman contradicted Keynes's theory and stated that during periods of higher earnings, consumption rather than savings will rise (Stuart, 2016). The model theorises that where perceptions of future income are tenuous, consumers will tend to save due to uncertainty. Conversely, most participants surveyed believe that people with steady income are more inclined to save than those with unsteady income.

Participants also believe that consumers display irrational buying habits with respect to short-term purchases but do save for the long-term in the form of illiquid assets. This is consistent with Laibson's Instantaneous Gratification Model (2005) which propositions that consumers display a high degree of impatience and irrationality with respect to purchases that yield near-term gratification and will utilise the remainder of income for default saving options. Hence, government's goal of deterring excessive credit purchases and pursuing an aggressive visibility campaign to change savings culture is pertinent.

Middle-aged consumers between the ages of 35 to 44 years were selected to be the most prominent age group that saves followed by younger investors between the ages of 25 to 34 years. This is in tandem with the Life-Cycle Hypothesis (Hussein *et al.*, 2017) which states that individuals will evenly spread consumption over the span of their lives but will tend to accumulate savings in their earning years, where there is a higher degree of job security and healthier income. Hence, the survey indicates that these conditions are most likely to occur between the ages of 35 to 44 years. Given that tax-free investments are long-term in nature, any addition to these funds at middle-age would reinforce income at retirement age. Research in South Africa (Ting & Kollamparambil, 2015) suggests that saving occurs at retirement age and is funded by government grants. This is contrary to the life-cycle hypothesis which states that dissaving will occur in retirement years as consumption is funded from past savings. The survey results are consistent with the preceding hypothesis as none of the participants believe that saving occurs beyond 55 years.

5.4 Demographic Factors that Affect Savings

Respondents were requested to rank, in order of importance, five demographic factors that currently impact the country's levels of saving. The five variables as identified from the literature review are financial education, disposable income of households, dependency on others, age of consumer and savings culture.

5.4.1 Financial Education

Participants have placed a high level of importance on the degree of financial education that investors possess. This corroborates the direct link between savings and financial education as evidenced by researchers (Beckmann, 2013), (Bhatt & Bhatt, 2012), (Mahdzan & Tabiani, 2013). Furthermore, one of the strategic goals of government is to increase visibility through educational campaigns so as to address low financial literacy. This obligation was reinforced by Syden (2014) who stated that government and the financial services industry need to take the lead in fostering a better saving's mentality by promoting financial education.

5.4.2 Disposable Income of Households

The survey results also found that disposable income of households held similar levels of importance to financial education. South Africa's low levels of saving can be attributed to high incidences of income polarisation and poverty (The World Bank, 2018). While studies conducted by South African researchers (Mahlo, 2011), (Mongale *et al.*, 2013), (Zwane *et al.*, 2016), found a positive correlation between income and savings, other researchers noted a negative relationship because increases in income were observed to lead to increases in consumption and not savings (Chipote & Tsegaye, 2014), (Simleit *et al.*, 2011). The participants surveyed believe there is a positive correlation.

5.4.3 Dependency, Age and Culture

Lower degrees of relative importance were placed on the dependency of the investor on others, the age of the investor and savings culture. These factors still yield an influence over household savings but not to the extent as income and

financial education. The life-cycle hypothesis postulates that savings is a function of age where savings is prominent amongst middle-aged groups due to their enhanced earning capacity and diminishes as one reaches retirement. Zwane *et al.* (2016) noticed a negative correlation between age and the head of the household implying that increased dependencies on the head of the household, such as those found in extended families, reduced savings. Furthermore, South African consumers are noted to exhibit a culture of material consumerism and savings will improve with an increase in self-regulation and sacrifice (Mail and Guardian Online, 2013).

5.5 Macroeconomic Factors that Stimulate House Saving

The literature review identified several economic variables that had the potential to stimulate savings. Opinions on policy that would stimulate economic growth or reduce levels of inflation, debt and unemployment were probed in the questionnaire yielding the following results.

5.5.1 Improving Economic Growth

Most respondents felt that the stimulation of economic growth would yield the best results in improving household saving above all other variables. Researchers are still contentious as to the causal relationship between income and growth. Some researchers believe that additional savings is a precursor to growth due to increases in investment (Djawoto, *et al.*, 2014). Others believe that increases in economic growth leads to increased savings via the injection of additional income into the economy (Abu, 2010). The survey respondents are in agreement with the latter proposition. Some researchers believe that there is a two-way causal relationship between growth and income (Najarzadeh *et al.*, 2014), (Turan & Gjergji, 2014) and Sekantsi and Kalebe (2015) who conducted studies in Lesotho found that causality ran from growth in the short run and from savings in the long-run. Moreover, Mohan (2006) found that causality ran from growth in developing countries and from savings in developed economies. Hence, respondents may be correct in placing such a high emphasis on growth in the South African context.

5.5.2 Reduction of Debt

Participants considered policies that reduced debt to be the second most important variable to stimulate savings and their sentiments are consistent with the literature review. Mongale *et al.* (2013) confirmed a negative relationship between savings and debt in South Africa and Government reported that debt to disposable income ratio reached an all-time high of 86% until the 2008 global financial crisis placed a squeeze on credit extensions (South African Parliamentary Budget Office, 2017). Thereafter, significant income was spent on servicing these debts leading to a steep drop in savings until 2013.

5.5.3 Unemployment, Tax Policy and Inflation

Reducing unemployment and tax policy were tied for the third most important factor to stimulate savings. Hence, given that this study intends to analyse the impact of tax-free investments on savings, it can be concluded that participants consider tax policy to be effective only on condition that other larger socio-economic variables are addressed. Improving employment will conjure the necessary income that is required for investment. Mongale *et al.* (2013) recommends the reduction of personal taxes to boost disposable income and increase consumption tax to plug the revenue loss. Consumption tax is a direct tax and may lead to a reduction in consumption. Although inflation was surveyed to be the least effective stimulus in comparison to the other variables, Syden (2014) concludes that high inflation has a positive effect on savings as households make precautionary savings based on economic uncertainty.

5.6 Characteristics of Tax-free Investments

Some of the key factors that define the successful application of tax-free investments is that policy must instil a positive savings culture in the long term and that investment products should be transparent, cost effective and provide a reasonable rate of return (National Treasury, 2012). Hence, participants were asked a series of questions to establish whether the above requirements were currently being met. Most participants agreed that money market accounts are best suited for short-term savings and that tax-free investments should be

considered with a long-term investment horizon in mind. A significant percentage of participants, however, remained neutral indicating they are unaware of the investment horizon. Furthermore, research conducted on the uptake of tax-free investments observed that 66% of accounts were being held for emergency savings and 60% of investors held cash accounts (Fisher-French, 2016). This is contrary to policy intention as tax-free investments will reap the greatest reward on an extended period of time via capital appreciation. Furthermore, additional concerns were raised about the large amounts of accounts that were cash-based as these returns may not keep up with inflation (Intellidex, 2017). Hence, policy requirements with respect to rates of return may not be met. Most participants agree that tax-free investment products are cost effective but many seemed to be unaware of the risk factors. 45% considered these investments to be low risk where an investor could not lose money and 38% remained neutral. In reality, tax-free investments consist of a myriad of products which are similar in nature to any other investment product and range from low risk cash-based accounts to higher risk equity accounts where market movements can result in capital loss.

5.7 Consumers of Tax-free Investments

A challenge and goal for Government is to ensure that tax-free investments are primarily utilised by middle- to low-income groups with some participation and asset shifting amongst higher income groups. Three questions were posed in this regard and a mean of 2.99 was achieved indicating mixed perceptions of who will benefit the most. Most of the participants believe that tax-free investments have procured new investments as opposed to old savings merely being redirected from traditional accounts to tax-incentivised accounts. On the other hand, the majority believe that higher-income groups will benefit the most and that tax-free investment will do little to break down the barriers to saving such as the lack of financial resources and savvy. These results are consistent with local and international observations where it was noted that participation rates were skewed towards higher income groups and that tax-free investments have not enticed low-income groups (OECD Tax Policy Studies, 2007), (Donnelly & Young, 2012), (Kesselman, 2015), (Visser, 2018). Hence, it can be concluded that policy has not achieved its goals in South Africa.

5.8 Comparison to Other Products

Other saving products include long-term investment schemes and short-term saving accounts. Participants were asked three questions regarding retirement funds, pre-existing tax deductions and whether they felt incentivised to sell tax-free investment products. An overall score of 2.8 was attained indicating that respondents have a negative perception of tax-free products in comparison to traditional saving products.

Retirement products and tax-free investments both provide tax exemptions for income and capital growth. The difference is that contributions to retirement products are tax deductible upfront and provide significant tax rebates while contributions to tax-free investments do not. Furthermore, while income and capital gains in tax-free products are exempt from tax, gains from retirement products are taxed during retirement years where the investor's marginal tax rate is generally lower than when they received a tax deduction. Hence, retirement funds have the advantage of providing a tax arbitrage and delaying tax.

A large percentage of participants felt that retirement funds are more likely to induce savings as contributions to these funds are tax deductible upfront. Furthermore, participants were undecided as to whether the pre-existing interest income deduction is adequate to incentivise saving. Respondents with a number of years of experience felt that the interest income deduction was not sufficient to stimulate new savings and less experienced participants felt the opposite or adopted a neutral stance. In addition, experienced consultants felt more incentivised to sell retirement products over tax-free products.

According to Marais (2016), retirement funds have the advantage over tax-free investments if the investor is currently on a high tax margin as they will receive a substantial tax benefit upfront. However, investors on a low tax margin should maximise their tax-free contribution first and then invest in other retirement products as they are likely to be on a higher tax bracket in future years and growth in their investments will be exempt from that higher tax rate. Either way, as long as consumption is reduced and diverted to savings, household savings will improve. Furthermore, tax-free investments were introduced to supplement retirement

savings and not replace it (National Treasury, 2012). Given that tax-free investments are long-term products, the current interest income exemption is sufficient for short-term emergency savings. The challenge that future investors will face is that the interest exemption will not be increased in future tax years and will therefore become redundant as inflation increases. This implies that investors will be forced into tax-free products, irrespective of the investment term, but will be bound by annual contribution limits which currently stands at R33 000 per annum. To cater for short-term savers, policy will have to be revised in the future to increase the annual limit so that investors can enjoy an equivalent tax benefit that is currently provided by the interest-income exemption.

5.9 Promotion of Tax- free Investments

Incentivising non-retirement savings (National Treasury, 2012) is a policy document that was drafted to address the culture of excessive debt-financed consumerism at the expense of saving and called for increased visibility through extensive educational campaigns. Participants were asked four questions to validate the success of these objectives and a mean score of 3.28 was achieved indicating a slightly positive perception in this regard.

Only one-third of participants believed that Government has implemented a robust educational program to create awareness and notably 42% of respondents remained neutral. The large proportion of neutral responses indicate that many are unaware of educational campaigns and more should be done to sway this opinion. Despite this, respondents concur that they are receiving an increase in tax-incentivised queries and that their clients are knowledgeable about these products. When questioned whether interest in tax-free investments were declining since induction, many respondents again remained neutral indicating an unawareness of the impact and sustainability of these products over the investment domain. Beckmann (2013) indicates a strong positive correlation between financial literacy and savings and accentuates low literacy for the lack of retirement planning and wealth. In addition, Finscope (2016) cites that a large percentage of South Africans are inadequately served by the finance industry with respect to the different demographic dynamics of investors.

5.10 Limitations of the Study

The following limitations of the study are acknowledged:

- a) This study was conducted in one of many branches of the insurance company. Therefore, results must be used with caution when extrapolating to the entire organisation.
- b) This study is based on the employee perceptions of an insurance company. There are many service providers of tax-free products besides insurance companies. Caution should therefore be used when extrapolating results to all service providers.

5.11 Conclusions

This study was undertaken to achieve the following objectives:

1. To evaluate the factors that affect household savings in South Africa
2. To examine the characteristics of tax- free investments and to assess its implementation and uptake
3. To predict its impact on household savings

Based on the results of the study, the following conclusions can be made:

1. Low levels of income, unsustainable consumption and the lack of financial savvy are the predominant factors that have led to low household saving. This has left many households servicing high levels of debt from any income received with little left for saving.
2. Participants believe that improved economic growth and the reduction of debt and unemployment will provide the greatest impetus to improve the level of savings.

3. Tax-free investments are considered to be long term, cost-effective investment vehicles that can boost savings. However, this study has found that the majority of account holders are saving for short-term emergency funding and that investment returns may not compete with other inflation-linked products. Hence, more educational initiatives are required to ensure that investors are utilising the correct investment options to cater for their individual needs. On the other hand, tax-incentivised schemes should be geared to provide more relief to short-term savers.
4. Although participants believe that tax-free investments have secured additional savings, participation rates are skewed towards higher-income groups and that these schemes have provided little relief for low- to middle-income groups. Similar trends were observed in international studies. Hence, policy must be revised to expand its appeal to low-income groups. A possible solution is to differentiate between long-and short-term products and allow contributions to the latter to be financed from pre-tax income.
5. Traditional retirement products are still the preferred investment option over tax- free investments as contributions are deductible upfront and income and capital gains tax are deferred till retirement. Furthermore, retirement products provide significant rebates which can be utilised as a cash flow source to fund further contributions to saving. Since tax-free investments require funding from after-tax income, they may not be the primary investment choice for households with low disposable income.

6. Despite Government's commitment to improve visibility around issues of debt and savings, many respondents were not convinced. Greater emphasis has to be placed on educational campaigns that reach all sectors of the population.
7. In light of the above observations, tax-free investments are unlikely to have a significant impact on household savings in South Africa until broader socio-economic issues are addressed. In future years, it will replace tax exemptions that currently exist and should therefore be geared to provide similar tax benefits that are currently available to short-term investors. Government and industry needs to boost visibility and educational campaigns to lure low- to middle-income groups. Tax-free investments will stimulate more savings amongst lower-income groups if they are tax-deductible in the year of contribution.

5.12 Recommendations for Future Studies

The following recommendations are made for future research on the impact of tax-free investments on saving in South Africa:

- a) Due to limited time and resources this study was conducted in a single branch of one of many service providers. Future studies should extend the scope to other service providers of tax-free products to obtain a global view of their impact on savings
- b) Employee perceptions were utilised to determine the impact on savings. Furthermore, tax-free investments have only been offered to the public over the last three years. Future studies can use empirical data over a longer period of time to analyse the impact on saving.

- c) A large number of neutral responses were received from participants indicating a knowledge gap on the subject. In light of the potential importance of tax-free investments to economic upliftment, it is recommended that the insurance company relook at their training content and product offerings to revitalise the sales of these products.

5.13 Summary

The current socio-economic landscape presents many challenges to South African consumers. These challenges have led consumers to be burdened by high levels of debt and insufficient levels of saving to fund present and future needs. Higher levels of household savings are acknowledged to improve resilience to expenditure shocks, boost investment and propagate economic growth. In response to these challenges, Government has introduced tax-free investments to incentivise non-retirement savings. This study sought to evaluate the impact that tax-free investments had on resuscitating savings to date.

It was observed that participant perceptions of tax-free investments were neutral and that tax-free investments fall short of achieving the desired results envisaged by Government. The product needs to be modified so as to be more appealing to lower-income groups.

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Appendix A: Ethical Clearance



09 December 2016

Mr Vikash Vishwadev Ganpath (214581630)
Graduate School of Business & Leadership
Westville Campus

Dear Mr Ganpath,

Protocol reference number: HSS/1922/016M
Project title: The impact of tax-free investments on savings in South Africa

Full Approval – Expedited Application

In response to your application received on 04 November 2016, the Humanities & Social Sciences Research Ethics Committee has considered the abovementioned application and the protocol have been granted **FULL APPROVAL**.

Any alteration/s to the approved research protocol i.e. Questionnaire/Interview Schedule, Informed Consent Form, Title of the Project, Location of the Study, Research Approach and Methods must be reviewed and approved through the amendment/modification prior to its implementation. In case you have further queries, please quote the above reference number.

PLEASE NOTE: Research data should be securely stored in the discipline/department for a period of 5 years.

The ethical clearance certificate is only valid for a period of 3 years from the date of issue. Thereafter Recertification must be applied for on an annual basis.

I take this opportunity of wishing you everything of the best with your study.

Yours faithfully,

[Redacted Signature]

Dr. [Redacted Name] (Chair)

/ms

Cc Supervisor: Dr Muhammad Hoque
Cc Academic Leader Research: Dr Emmanuel Mutambara
Cc School Administrator: Ms Zarina Bullyraj

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Founding Campuses: Edgewood Howard College Medical School Pietermaritzburg Westville

Appendix B: Questionnaire

1. Please indicate your length of experience as a financial/sales advisor

Experience	Less than 1 year	1 – 3 years	4-10 years	Greater than 10 years
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2. Please indicate your highest level of education

Education	Matric	Diploma	Bachelor's Degree	Honours/Postgraduate Diploma	Master's Degree	Doctorate
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3. Please indicate your current occupational role

Role	Academy Advisor	Financial Advisor	Senior Financial Advisor	Executive Financial Advisor	Sales Manager	Area Manager	Regional Manager
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4. Please indicate the approximate size of your client base

Number of Clients	Less than 100	100 - 500	501 - 1000	Greater than 1000
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5. On average, how much do your clients earn per annum?

Less than R50 000	R50 000 - R100 000	R100 000 – R300 000	R300 000 – R500 000	R500 000 – R750 000	R750 000 – R 1 million	Greater than R1 million
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Based on your experience and interactions with clients, please mark the applicable boxes below

6. The most important factor that promotes saving is disposable income

Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
----------------	-------	---------	----------	-------------------

7. The most prevalent age group that saves are

Under 25 years	25 – 34 years	35 – 44 years	45 – 54 years	55 – 64 years	65 years and older
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8. People with stable income save more than people with unsteady income

Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
----------------	-------	---------	----------	-------------------

9. I have noticed that people have a tendency to make small and irrational purchases in the short term but will save in illiquid assets (e.g. property, shares) in the long term

Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
----------------	-------	---------	----------	-------------------

10. The factors below have an impact on the level of national savings. Please rank in order of importance (1 – 5) the factors you consider to have the greatest impact on savings where 5 would have the greatest impact and 1 the least

Factor	Level of Financial Education	Race/Culture	Age	Disposable Income	Dependency on Others
Ranking					

11. The factors below have an impact on the level of national savings. Please rank in order of importance (1 – 5) the factors you consider to have the greatest impact on *improving* savings where 5 would have the greatest impact and 1 the least

Factor	Improving Economic Growth	Reducing Unemployment	Reducing Inflation	Reducing Personal Debt	Increasing Tax Incentives
Ranking					

12. Tax free investments have encouraged new and additional savings as opposed to old savings being redirected into tax incentivised accounts

Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
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13. Tax incentivised saving schemes will do little to break down the barriers to saving faced by low income groups. (Barriers to saving include little or no income, lack of financial education, no access to financial products, etc.)

Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
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14. The wealthiest will benefit the most from tax-free investments

Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
----------------	-------	---------	----------	-------------------

15. Money market accounts are more suited to short term savings than tax free investments

Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
----------------	-------	---------	----------	-------------------

16. Tax-free investments should be considered as a long term investment

Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
----------------	-------	---------	----------	-------------------

17. Contributions to retirement funds are more likely to induce additional savings as they are tax deductible upfront

Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
----------------	-------	---------	----------	-------------------

18. Tax-free investments are cost effective

Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
----------------	-------	---------	----------	-------------------

19. Tax-free investments are low risk investments where an investor cannot lose money

Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
----------------	-------	---------	----------	-------------------

20. The government has implemented a robust educational program to create an awareness around the importance of saving

Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
----------------	-------	---------	----------	-------------------

21. The pre-existing interest exemption of R23 800 per annum for persons under 65 years is sufficient to incentivise savings

Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
----------------	-------	---------	----------	-------------------

22. I have received an increasing number of queries regarding tax-free investments over the last year

Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
----------------	-------	---------	----------	-------------------

23. My clients are aware of the risks and costs associated with the different types of tax-free investment products

Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
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24. I am incentivised to sell tax free savings and investment products

Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
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25. Interest in tax free investments are declining

Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
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Appendix C: Informed Consent



Personal Financial Advice

Durban Berea

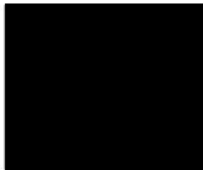
4th Floor Musgrave Centre, Suite 401, Musgrave Road, Durban, 4001
PO Box 30346, Mayville, 4058, South Africa
Tel +27 (0)31 250 4000, Fax +27 (0)31 250 4100
Web : www.oldmutual.co.za

For attention
Chair of Ethics Review Committee
University of KwaZulu-Natal
Durban
4001

27 May 2016

RE: LETTER TO SUPPORT VIKASH V GANPATH, STUDENT NUMBER 214581630 – GRANTING PERMISSION TO ADMINISTER QUESTIONNAIRES

Old Mutual has considered a request from VV Ganpath to administer questionnaires to staff members to obtain research data for his dissertation "The Impact of Retirement Reforms on Savings in South Africa". We wish to inform you of the acceptance of his request



Area Manager – Durban Berea

To report unethical behaviour, call the Anonymous Reporting line
0800 222 117 or visit www.oldmutualanonymoureports.co.za

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PPB Hanratty (Chairman) (Irish), RT Mupita (Chief Executive Officer), PC Baloyi, PG de Beyer, PW Feeney (British) Prof IA Goldin, Ms AA Maule, Ms CE Maynard, Ms K Murray (British), BM Rapiya, JVF Roberts (British), F Robertson, Mrs G I Serobie, AH Trikamjee, PGM Truysens (Dutch) and GS van Niekerk.
Company Secretary: RF Foster

Appendix D: Turnitin Report

Document Viewer

Turnitin Originality Report

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The Impact of Tax-free Investments on Savings... By Vikash Ganpath

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