

HOUSEHOLD SAVINGS IN THE REPUBLIC OF NORTH MACEDONIA - SEVEN YEARS LATER

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Abstract It has been scientifically proven that the process of financial market development involves strengthening of the financial system preceded by simple capital accumulation which in turn is closely related to the savings rate. The higher the level of financial development, the greater the financial intermediation and the economic growth. Financial development reduces inequality and poverty by super-proportionately accelerating the growth of emerging countries and implying a reduction of inequality in the world. This paper expands the time frame of the analysis in the research conducted in 2012 of a statistical sample of 1250 respondents. Based on new data seven years later and using the previously defined variables on the same size of the statistical sample, this study aims not only to confirm the basic thesis that in the Republic of North Macedonia savings (as the main source of financing domestic banks) are still at a low level, and that the examined variables which are directly proportional to savings generally have a downward trend but it also aims to emphasize the strong impact on (mis)trust in financial institutions, related to savings. Hence, this paper will note proposed measures to increase the level of savings.

Keywords:

financial development, economic growth, poverty, saving, ethical standards

1 Introduction

There are numerous theoretical and empirical studies proving that only a well-functioning and stable financial system can be a pillar of economic growth and ensure a reduction in poverty and inequality in the world. The effective financial system responds to the demands of the non-financial sector at the same time encouraging economic growth. Financial institutions, such as financial intermediaries, mobilize and allocate savings in the real sector, enable the reduction of information and transaction costs, explore and rank potential investment projects according to their profitability, carry out corporate control, manage risk, mobilize savings, and facilitate exchange. Costs of financial underdevelopment and instability in terms of economic growth are high. Underdevelopment and instability lead to a high average rate of insufficient utilization of production capacities, which then reduces the productivity of capital. On the other hand, the uncertainty associated with the variability of the growth rates has negative effects on the accumulation of capital (Loayza et al., 2003). In 2000, the renowned economists *Levine, Loayza* and *Beck* examined the measures that are indicators of financial intermediation. The findings of the research carried out in 74 countries between 1960 and 1995, comparing average data for each five-year interval, show that countries with a private credit measure of less than 10% of GDP (Zaire, Sierra Leone, Ghana, Haiti and Syria) have lower i.e. negative rates of -0.5% of GDP growth, relative to countries where this measure is above 85% of GDP (Switzerland, Japan, the United States, Sweden, the Netherlands) and the GDP growth is over 5% per annum within the entire observed 35-year period. In the first group of countries with low private credit, the banking system was damaged as a result of state ownership of banks, state interventions on asset allocation policies, high level of delinquent loans, interest rate controls, numerous restrictions in banking strategies, etc. Within the same research, it was established that the value of the private credit measure in India in the period 1960-1995 was 19.5% of GDP and in Argentina 16% of GDP, while this value in the developed countries was 25%. The results show that the convergence of the private credit measure to that of the developed countries would provide India with faster GDP growth of over 0.6%, while in Argentina it would increase by 1.8%. It has been established that if Mexico with a return on equity of 36% would achieve a return at the average rate of OECD countries (68%), the growth rate would have been higher by 0.6% per annum. Similarly, if the bank loan indicator would have been, instead of the actual 16%, at the level of OECD countries of 71%, then the growth would

have been faster by 2.6% per annum. In 2004, *Rioja* and *Valev* noted that finances accelerate growth in rich countries primarily by increasing productivity growth, and in poorer countries by increasing the accumulation of capital. *Benhabib* and *Spiegel* in 2002 found that the indicators of financial intermediation are correlated with the total factor productivity, while the accumulation of capital is correlated with both physical and human capital. *Loayza* and *Ranciere* in a 2006 study examine the link between finance and economic activity and summarize that the dominance of short-term bank lending is a signal of economic stagnation and economic crises. *Rousseau* and *Wachtel* in 1998 investigated the connection between financial innovation and financial depth in the US economy for the period from 1872 to 1929. This research confirms that the permanent reduction in the expansion of the banks by 1% is associated with an increase in the financial depth from 1.7% to almost 4% and that financial innovations increase the financial depth, which is closely related to economic growth. Similar to this, *Levine* and *Zervos* and *Bekaert*, *Harvey* and *Lundblad* show that financial liberalization accelerates economic growth by improving resource allocation and investment rates. *Haber* concludes that international differences in financial development have a significant impact on the extent of industrial expansion in the countries, noting that underdeveloped financial systems, which limit access to institutional sources of capital, hinder industrial expansion. *Rajan* and *Zingales* summarize that better developed financial intermediaries and financial markets facilitate the access to external financing of companies, which is cheaper than internal financing (equity financing: shares and/or reinvested earnings) and with that supports the growth of companies as well as the economic growth. This research examined 36 industries across 42 countries in the United States. It has been concluded that the increase in financial development super-proportionally increases the growth of industries which find it more difficult to use external financing, and that financial development generates industrial growth through the expansion of existing and/or introducing new industries to the economy. Based on this research, *Beck* has linked finance and growth of small companies and found that industries inherently nurturing smaller companies grow faster in countries with a better-developed financial system. This is explained by the fact that small companies face larger information and financial issues as compared to large companies. It is therefore essential to have a developed financial system to ensure the support to the growth of these companies, It has also been found that the percentage of population living with less than two dollars a day decreases faster in countries with a higher level

of financial development, and that financial development super-proportionately accelerates the growth of poor countries thus reducing inequality in the world.

All above-mentioned research proves that the overall financial development and complementarity of the banking and non-banking financial institutions explain the successful growth in many countries, and that the development and proper and efficient functioning of financial institutions depends on: the legal framework and the regulatory mechanisms, the protection of property rights, the ethical standards of the financial institutions and the promotion thereof among economic agents, consistent and swift implementation of the agreements, protection of investor rights, the existing cultural specifics, comprehensive and internationally comparable accounting standards, transparency of economic agents, the macroeconomic agenda, political stability, etc.

2 Focus on Macroeconomic Condition in the Republic of North Macedonia

After the independence in 1991, the Republic of Macedonia began to lay the foundations of a market economy. Alongside the process of ownership transformation in the real sector, the new legal infrastructure and regulations were developed, the foundations of the Macedonian Stock Exchange were laid, remediation of the banking sector was conducted (the cost of remediation of the banking sector reached 42.3% of GDP at the end of 1995 and 45.8% at the end of 1999, which makes it one of the most expensive recovery processes in the world). This was due to the fact that the banks were granting credit allocations without previous loan analyses, outside market and economic principles, often with insider participation in the decision-making process for loan approval by the borrowers themselves. As a consequence, a high percentage of uncollectible and delinquent loans were accumulated in the assets of the banks, which in turn attracted unrealistically high-interest margins on the passive and active interest rates. The total assets of the financial system account for 89.8% of the gross domestic product. The financial sector retained this relatively simple structure with the dominant role of the banking system and a fairly small role of non-deposit financial institutions. In 2009, the banking system participated with 88.7% in the total assets of the financial system, in 2012 with 88.5% and in 2017 this share was 83% (NBRM, 2010,2018), which confirms that the banks remain the dominant and most important institutional segment in maintaining the stability of the entire financial system. Although with a

significantly lower share compared to the banking sector, the next most important financial institutions are the insurance companies and the mandatory pension funds, as the second largest contributor in the financial sector with an equal share. In 2017, household deposits with 50.8% share in the total banking assets remain the primary source of banking assets with a high share in national savings. Deposits of non-deposit financial institutions with the banks at the end of 2017 accounted for 3.2% of the total deposits and 4.3% of the total assets of the banking sector.

3 Methods

For the purposes of this paper, 7 years after the original research in 2012, the null hypotheses is again that the household savings rate (as the main source of credit potential of the dominant banks) is still at a low level; furthermore, insufficient information about the existence and adherence to the ethical standards of financial institutions continues to have a significant impact on mistrust thereof, and affects the savings rate. Hence, one of the hypotheses is that raising awareness of and informing economic agents about the adopted ethical standards of financial institutions will lead to an increase in the level of savings. Also, one of the aims of the research is to statistically define the trends of the examined variables in the seven-year timeframe and provide an assessment of thereof.

In order to prove that savings, as well as the knowledge about the ethics in savings in Macedonia are at a low level, a research was conducted on a random statistical sample of 1250 respondents (*Mojsoska, Dujovski, Nikolovska Vratevska, 2016*). The researchers proved the set hypothesis that the savings rate within the population of the Republic of Macedonia (as a dominant source of the activities of the domestic financial institutions) is at an insufficiently low level, as is the knowledge of ethical saving. Hence, the influence of financial institutions implies a low level of economic growth and development. The questions were elaborated in the Statistical program SPSS 19 and 7 variables were defined. The data from this research were elaborated by the basic descriptive statistical procedures. In the descriptive statistics for each of the variables, the basic measures of central tendency and dispersion were estimated, and the results were grouped in classes (frequency analysis). Analysing the data where the basic statistical parameters of 7 variables were given, we can state that the distribution of the results in most variables is mostly within the normal margins of distribution. Certain decline from the normal distribution is observed in variables 6

and 7, due to the content of the 5th variable - it is not in favour of saving, as well as to the 7 modules of responding within the variable 6. The estimated measures of variability (*Std. Dev.*, *Skewness*, *Kurtosis* and *KV*) with only a few exceptions show a relatively high degree of homogeneity in relation to the average values in each variable.

In order to examine the set hypotheses from today's perspective and to determine and evaluate the trends of the set variables within the timeframe of seven years, the questionnaire was re-distributed to 1250 randomly selected respondents.

4 Results and discussion

Statistical data processing in relation to the first variable in 2012 gave the following results: the percentage of saving households was 47% while those who did not have savings amounted to 52%; in 2019 these percentages indicated 56% of savers and 44% of non-savers. In 2019, there was a trend of growth in the number of households saving by 8,8% and decline of non-saving households.

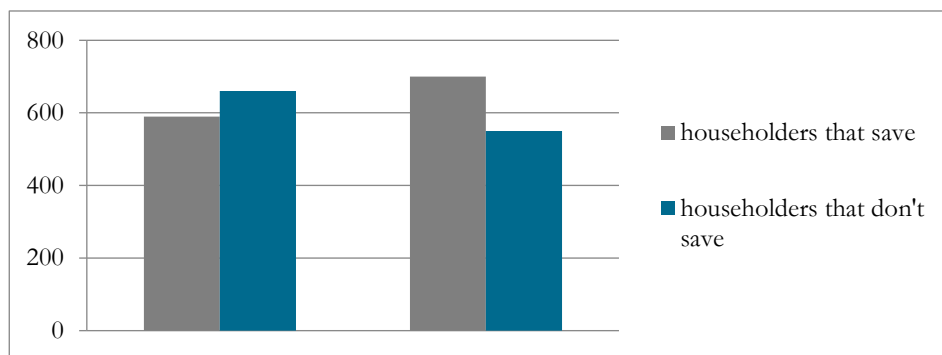


Figure 1: Comparison of saving and non-saving households 2012-2019 The results indicate that the number of saving households in the first group grew by 12% while in the second and third groups it had grown by 20%.

Analysing the results obtained from the first two variables, it has been found that there is a trend of increase in the number of saving households and with that, a trend of growth in the amount of household savings. In an environment of low and declining interest rates on time deposits, the assessment is that during the analysed

time interval in the national economy, this was affected by the continued political instability (rational expectations of economic agents whereby consumption is postponed till future times and saving is preferred), as well as the growth of 14.3% of the average salary in March 2019 compared to March 2012 as noted by the State Statistical Office.. The results obtained from households that do not have any savings at all and the saving households - how much of their income goes to savings - unequivocally indicate that household savings (as the primary source of bank assets) are still insufficient to provide the required accumulation of capital for a financial system in function of growth and development of the economy.

In addition to this auxiliary hypothesis, the following groupings of homogeneous modules also go into the following groups: 1) the number of respondents from the module two of the third variable (the number of households that the savings do not invest in the financial institution) with the module two of the fourth variable of households who would not have invested in a financial institution if they had any savings); 2) and the second group of respondents from the module one of the third variable (saving and investing in the institutions) with the respondents from the module one of the fourth variable (which if they would save, they would invest in a financial instrument). An overview of the results obtained is given in Table 2:

Table 1: Reasons for not investing in financial institutions, comparative 2012-2019

2012 Crosstabulation

Count

		1	2	3	4	5	Total
2012	Yes	90	10	10	80	10	200
	No	80	10	10	90	20	210
Total		170	20	20	170	30	410

2019 Crosstabulation

Count

	1	2	3	4	5	Total
Yes	100	20	20	100	10	250
No	20	30	30	100	40	400
Total	30	50	50	200	50	650

Legend: 1- constant need for cash.

2-no existence of financial instruments for household needs.

3-insufficient knowledge of the ways and conditions for investing as well as the benefits and risks.

4-distrust in financial institutions.

5-other, specified:investments in own business.

- „Yes” – Housholders that save

- „No” – Housholders that do not save

The results confirm the sub-hypothesis that after 7 years, we have an even higher number of respondents who do not nor would invest in a financial institution, which further weakens the deposit base collected from the invested insufficient mass of household savings as a potential in the economy for credit rating in the real sector.

The purpose of the fifth question was to determine the reasoning behind the decision not to invest the savings in a financial institution. In the analysis of 2012, the percentage of respondents who do not nor would invest in a financial institution was as follows: 38.1% said that they would not invest due the constant need of household cash reserves (liquid assets), 7.1% noted the lack of financial instruments in which they would invest to meet the requirements of their household, 4.6% had insufficient knowledge of the manner and conditions for investing in the financial institutions, as well as the lack of knowledge of the ethical standards of the institutions, , a dominant 40.5% of the respondents noted as a reason the mistrust in the financial institutions, and 9.5% chose Other: specifying that they would invest in starting their own business. The research into this variable in 2019 showed the following: 45% do not nor would invest their savings due to the constant need for cash; 8% do not nor would invest due to the lack of financial instruments that would be appropriate to their needs; 8% stated as a reason their insufficient knowledge of the investment conditions of, benefits, risks and ethical standards of the financial institutions; 31% said that the reason was mistrust in financial institutions while 8%

specified that they would invest in their own business. Within this variable, and according to the principle of homogeneity of the content of the modules, the first and the fifth module were grouped together (a group comprising respondents who have a constant need for cash in the household or for investments, for example, in their own business), with the second, third and fourth modules being grouped together to encompass respondents who do not have sufficient knowledge on finances, instruments, and risks of investing, lack knowledge of the ethical standards of the institutions and do not trust them.

It has been concluded that in 2012, 50% of the respondents stated as a reason for not investing in financial institutions, the constant need of cash in the household and/or for the investments (in 2019, this share is 53.8%), while 50% said they lack information about investment conditions, ethical standards of institutions or lack of trust in the financial institutions (in 2019, this share was 46.2%). The results, presented, affirm the sub-hypothesis that insufficient knowledge of the manner and conditions for investing in financial instruments as well as the insufficient knowledge of households in the ethical standards of financial institutions result in mistrust thereof and in a low level of savings and investments in the financial instruments. The analysis indicates that the ethics is a strong factor of influence when deciding whether and how much will be saved, and if the savings will be invested in the financial market.

5 Conclusion

The overall financial development and complementarity of banking and non-banking financial institutions help explain the successful growth of many countries. The existence of a well-functioning developed, and integrated financial system and financial institutions is reflected in the increase of competition, the quality and type of offered financial services and instruments, reduction of financial intermediation costs, which in turn encourages savings as a potential for further investment activity in the economy. The research confirmed the theses that in North Macedonia, seven years later, there are still insufficient savings, the savings are not fully invested in the financial institutions, and that the respondents are not suitably familiar with the opportunities and benefits of the investments in the financial market, or with the existence and adherence to the ethical standards of financial institutions, nor do they trust the financial institutions. All this creates an opportunity to educate and raise

awareness of a high percentage of economic entities on the conditions, benefits, risks and the interest rate of savings invested in financial instruments, as well as the adopted and applied regulations and ethical standards by the national financial institutions as measures aimed at enhancing both trust and savings. These promotional and educational activities would be accompanied by the development and implementation of strategies to ensure growth and development of the financial system within the macroeconomic and macro-financial policies: modernization of the financial system and the presence of a wide range of financial instruments in the domestic financial market, its international integration, accelerated development of non-banking financial institutions, consistent application of ethical standards and transparency, strengthening of the regulatory framework and efficient justice system.

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