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What Are the Demographic Determinants of Savings? An Analysis on Transition Economies (1993-2013)

A. Cansin Doker^{a*}, Adem Turkmen^a, O.Selcuk Emsen^b

^aErzincan University, Erzincan, 24000, Turkey

^bAtaturk University, Erzurum, 25000, Turkey

Abstract

In recent years, there have been many discussions about savings and growth especially for developing countries. The saving concept has an important and crucial place in all economies. Indeed, the importance of savings leads to the discussion of determinants of savings in the literature. Moreover, with an awareness of the determinants of savings, the government have to put effort for increasing savings with using policies and precautions on their institutions. In this point, raising the savings of a household, which is an important element of economic life, has gained an crucial role. However, it is clear that all factors which have impacts on it should be known to solve this issue. Narrowing into transition economies, which transitioned from a planned economic system to market economy, the structure of savings has changed from public funds to private savings. It is clear that saving habits cannot change or adapt in the short term, in fact this paper aims to put forward recommendations to policymakers in transition economies. In this paper, it has been investigated how demographic determinants are effective on saving ratios using panel data analysis between 1993 and 2013 on 20 transition economies. The chosen demographic and economic variables are dependency ratio (total, youth and old), GDP per capita growth, population density, urban population of percentage of total population, female participation of labour force, unemployment rate.

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1. Introduction

Savings accumulation and economic impacts of individual savings behaviours are two of the most fundamental

* A. Cansin Doker. Tel.: +90 555 718 2616.

E-mail address: acdoker@erzincan.edu.tr

concepts in economics, as discussed throughout economic history. The schools shaping the economic thought have tried to add different interpretations of these concepts by drawing from different points. Classical economic thought states that savings, as the source in capital accumulation and in growth models, are among the reasons for either growth or the recession. In contrast, the neo-classical model focuses on investments in directly supporting the effect of the savings and the savings are still placed as the source of growth. In this context, the differential point of Keynesian economics from Classical school can be defined as the paradox of savings, which is defined such that an increase in individual savings has individual benefits whereas in contrast an increase in national savings can cause a leak in the economy. Contrary to Keynes, Nurkse (1966) evaluated the results of the lack of savings, which means the fate for poor countries is a lack of savings in the least developed countries creates a vicious circle of poverty. According to Nurkse, low income level causes inadequate savings; relatedly this brings low-investments, which then turns to failure of production, employment, income and savings (Nurkse, 1966). The studies based on individuals' savings are placed in the literature under the consumption theories. One of the first studies on this subject belongs to Irving Fisher (1930). Fisher, in his study, revealed that savings identified with the resolution of the two-term intertemporal optimization problems for the consumer who lived two periods including present and future (Fisher, 1930). Fisher expressed current savings as giving up present consumption and current debt as an abandonment of future consumption.

According to the absolute income hypothesis (1936) by Keynes, who linked savings with income, savings and consumption are caused by disposable income and both are positively correlated with it. In other words, while disposable income increases, consumption also increases, but it will increase less than income. Therefore, with revenue growth and average consumption the trend is correlated negatively and the average saving trend is correlated positively with income (Keynes, 2008). The Keynesian approach about average consumption trends decreasing over time can be described as a saving paradox in the context of pushing the economy into recession with an aggregate demand contraction. Simon S. Kuznets (1946), after testing absolute income hypothesis in the long run, claimed that the average consumption trend is a steady state, not decreased. In light of this finding, this is called in the literature the consumption puzzle. In this aspect, he stated that later it is used as the assumption that the theory of consumption is smoothing into the absolute income hypothesis (Kuznets, 1946). James S. Duesenberry (1949), in his study based on the relationship between income and savings he found that individuals specify their consumption decisions depending on income of the society in which they live, namely the relative income of consumers. This situation can be explained with the Veblen effect for consumption decision, and additionally Duesenberry indicated that income distribution can also be effective on decisions of saving and consumption (Colak and Ozturkler, 2012). Moreover, Duesenberry, in his paper called relative income hypothesis, added that in the face of the income decline, individuals adapt their consumption with delay while in the face of increase they will immediately adapt their consumption, which is called the ratchet effect. In respect of savings this can be written that savings fall faster than consumption with a decline of income, while savings rise slower than consumption with an increase of income (Duesenberry, 1949).

The life cycle income hypothesis developed by Franco Modigliani and Richard Brumberg (1954) mentions that the demographic impacts of savings and the life time consumption of individuals, who consider consumption flattening, is related with their life time income. In this concept, individuals will be indebted for consumption which they need in their retirement. The negative savings they owe will be financed with their positive savings by earnings income from their working period of time. Therefore, in terms of individual savings, the increased efficiency of the dependent population is negative, while an increase in the active working population will affect positive savings (Modigliani, 2006). After Modigliani and Brumberg, demographers improved their life cycle scheme, and childhood as well as retirement is added to the life cycle (Coale and Hoover, 1958). Economists have also expanded the model by including an individual's micro economic behaviours. Tobin (1967) added other variables such as a positive interest rate, probabilistic life span, income profiles for men and women and two periods of dependency with dissaving. Coale and Hoover (1958) also suppose that mortality and fertility may have an effect on life cycle savings behaviour. Three main conclusions from this hypothesis are; first, national savings behaviour is connected with the growth rate of the economy, second, pension plan while the level of wealth in the economy and hence the determination of national savings and third, another important factor that determines the national economy is the demographic structure of the population (Colak and Ozturkler, 2012).

The permanent income hypothesis by Milton Friedman (1957) was built on consumption being a continuous

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