Understanding Domestic Savings in Latin America and the Caribbean

A Project of the Latin American and Caribbean Research Network

There is a widespread perception among academic and policy circles that domestic saving rates are low in the Latin American and Caribbean (LAC) region. On average, domestic saving rates in LAC have remained stagnant at approximately 18 percent of GDP since the 1980s, compared to over 30 percent in fast-growing East Asia. However, it is not clear that cross-country comparisons such as this one are the right way to evaluate the level of savings in an economy.

Saving rates in an economy depend on various factors, such as: (i) demographic trends; (ii) income growth and how growth is distributed across generations; (iii) age profile of earnings for different cohorts in the population; (iv) pension and old-age living arrangements; (v) asset markets and intertemporal trades available to individuals; (vi) individual preferences and their heterogeneity—including aversion to uncertainty and precautionary motives; (vii) future growth expectations. Different theories about saving behavior and the quantitative importance of the various factors mentioned here can generate a variety of patterns at the aggregate level. Therefore, it is not surprising that countries at different stages of demographic transition and with varying growth experiences have different aggregate saving rates.

Nevertheless, it is surprising that saving rates in LAC have remained stagnant, despite the favorable demographic transition under way in the region since the 1970s. Why haven't aggregate saving rates changed much? Are there factors constraining savings in the region? More generally, it is interesting to establish facts such as why (and whether) people are saving. Who is saving? What are the main motivations? What vehicles do people use for saving? How important is saving for retirement? What is the relationship between saving and inequality? What is the impact of financial development on private saving? What is the relationship between financial crises and private saving—between precautionary saving due to classical risk aversion and Knightian uncertainty aversion?

A country's saving rate may be considered suboptimally low if there are identifiable factors that distort saving decisions. Therefore, an alternative to international comparisons in evaluating the level of savings in LAC is to search for idiosyncratic distortions in saving decisions. Moreover, since (aggregate) domestic savings are the sum of both public and private savings—where the latter results from the aggregation of households' and firms' savings—identifying sector-specific distortions could be extremely helpful in terms of policy design. The challenge for the researcher is establishing which factors are relevant in each case, and this can be done with the combination of micro and macro data.

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