RURAL SAVINGS MOBILIZATION IN KOREA : ISSUES, POLICIES AND SUGGESTED MEASURES

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I. Introduction

A decade ago, savings mobilization was termed "the forgotton half of rural finance" (Vogel 1984). However, the importance of rural savings mobilization(RSM) is recognized recently in many developing countries. There are many reasons. First of all, many developing countries have been facing problems in continuing to obtain large amounts of foreign capital with the desired term and interest conditions. This is the same in agricultural sector for its development programs. Secondly, it has been supported that savings among the rural folks are existent. Although most farmers were thought to be too poor to save, they have shown a remarkable ability to save in financial form when confronted with incentives that make such savings attractive. Thirdly, to create rural financial markets, rural savings mobilization is indispensable.

Korea is viewed as one of the most successful countries in terms of rural savings mobilization in Asia. However, until twenty years ago, it had been quite unsuccessful. After early 1970s, many innovative savings and credit schemes had been deviced, and it had contributed to increase rural savings.

The purpose of this paper is to present some information about rural savings mobilization experiences and issues in Korea. Also, some measures are identified to promote rural savings mobilization in Korea.

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II. Present Situation of Rural Financial Markets

1. Farm Household Financial Situation

The Korean agricultural sector has experienced a prolong period of depression during the 1980s. Approximately one third of total number of farmers were facing the problems of declining ability to service existing debts. Other farmers, who might have less serious financial problems, were concerned that further agricultural depression will put them in the same position. Similarly, many farm lenders have faced their own stress because of delinquencies, high loan losses, and possible loan defaults.

Financial distress of the farm economy did not suddenly develop. It was strongly rooted in the events of the early 1980s. Farmers reacted to high inflation by expanding livestock production and heavily investing in farm machinery and facilities. In mid-1980s, these elements abruptly reversed its direction, and farmers were confronted by excess capacity of livestock production relative to a weakened domestic demand, slow down inflation caused by government control, and high real interest rates.

Livestock price peaked between 1982 and 1983, declined by 45 percent in 1983 and 1984, and held steady in 1985 and 1986. Large amounts of beef imported during the 1982~1984 period. About 40 percent of domestically consumed beef were provided by imported beef during this period. As a result, price of livestock and beef declined.

Accelerating inflation in the 1980-1981 period had an important effect on agriculture since it caused real interest rate to remain low or even to negative. Low real interest rates provided farmers with strong incentives to invest in livestock and capital equipment in the early 1980s. However, the real interest rates at the farm level abruptly rose to approximately 10 percent since 1983. The major factor causing to his reversal was the government price control to the agricultural products. Because of anti-inflationary policy, the government purchasing price of rice did not increase at all during the 1983-1984 period, and increased only about 3 percent during the 1985-1987 period.

As a result, the rate of increase in the net farm income had been very low during this period.

The amount of farm household income was 6,535 thousand wons in 1987. It is about 7.5 times higher than that of 1975. The annual rate of increase in the farm household income was 25.3 percent during the 1975-80 period whereas it was 16.3 percent in the 1980-85 period. Savings ratio of the farm households decreased from 26.0 percent in 1975 to 18.7 percent in 1987. The average savings ratio of urban household was higher than that of the farm household in recent years. It is because that the farm household spends more miscellaneous expenditures than its counterpart urban household. Expenditures for marriage and funeral ceremonies, transportation and communications are usually counted as miscellaneous item, and expenditures for such activities are considered more important by farm households than urban household. For example, in 1987 the amounts of spent by farm households on miscellaneous item was 2,304,000 wons compared to only 1,337,000 wons by urban households.

TABLE 1 Assets, Income, Expenditure, Saving and Debt of Korean Farm Households, 1975~87

year	Assets* (A)	Income (B)	Expenditure (C)	Saving (D=B−C)	Debt (E)	D/B	E/A	E/B
	··············	··············	1,000 Won	··············	··············			
						%	%	%
1975	4,588	873	646	227	33	26.0	0.7	3.8
1980	13,384	2,693	2,288	405	339	15.0	2.5	12.6
1982	18,804	4,465	3,479	968	830	21.7	4.4	18.6
1984	26,894	5,549	4,386	1,163	1,784	21.0	6.6	32.1
1985	28,378	5,736	4,774	962	2,042	16.8	7.1	36.3
1987	33,091	6,535	5,316	1,219	2,390	18.7	7.2	36.6
			Annual increasing rate					
	%	%	%	%	%			
1975~1980	23.9	25.3	28.8	12.3	59.3	–	–	–
1980~1985	16.2	16.3	15.8	18.9	43.0	–	–	–
1985~1987	8.0	6.7	5.5	12.6	8.7	–	–	–
1975~1987	17.9	18.3	19.2	15.0	42.9	–	–	–

* It includes tangible and intangible assets.
Source: MAFF, *The Results of Farm Household Economy Survey*, 1975, 1980~1987.

TABLE 2 Average Propensity to Save (APS) of Farm and Urban Households, 1983, 1986, 1987

Year	Farm Household			Average	Urban Household
	Small Size	Medium Size	Large Size		
1983	15.4%	20.8	23.9	19.7	15.0
1986	11.9	11.9	27.9	16.1	24.8
1987	11.2	19.3	28.5	19.9	26.0

Note (1) Small size is defined as a farm household which operates less than 0.5ha of farm land.

(2) Medium size is defined as a farm household which operates more than 1.0ha but less than 1.5ha of farm land.

(3) Large size is defined as a farm household which operates more than 2.0ha of farm land.

Source: MAFF, *Farm Household Economy Survey*, 1983~1987.
EPB, *Urban Household Economy Survey*, 1983~1987.

Farm households' saving ratio tends to be positively correlated with land size (Table 2). In 1987, the APS of the large size farm household (More than 2.0ha) was 28.5% whereas that of the small size (less than 0.5ha) was 11.2%. In case of the APS by land tenure, any no significant differences were found among owner, owner-tenant and pure tenant farmers. In 1987, the APS of owner, owner-tenant, and pure tenant farm household were 21.7%, 19.4% and 22.6%, respectively. It seems that tenancy status itself does not affect to savings capacity. Rather the level of income or attitude toward savings seems to more important than other factors in Korea.

The annual growth rate of farm household saving is higher than that of farm household expenditure during the 1980-1987 period. During the 1980s, many farm households were forced to save because they were obliged to service and pay the principals and interests of their debts. As already noted earlier, farm households debt reached a serious level in this period.

Savings attitude differes from households with different family structures and income sources. Young farmers are usually less willing to save than older farmers. Older farmers are usually forced to save for their children education and other ceremonial expenses. Also they grew up under the situation that saving was a virtue, and that being a borrower means bankruptcy of the family.

Part-time farmers are more inclined to save than full-time farmers. The average propensity to save of the part-time farmers is usually higher than full-time farmers. This might be the reason that part-time farmers receive more cash income than their counterpart full-time farmers, and the variation of their monthly income is more stable than the full-time farmers.

Farmers have several motives to save. However, building up a reserve against unforeseen contigencies and preparing for an anticipated expenditure seem to be most important motive to save for Koeran farmers. As shown in Table 3, about 30 percent of the farmers being interviewed save to utilize an unexpected surplus of family budget or to prepare themselves for unforeseeable expenditures. Twenty-two percent of the respondents expressed that their main purpose of saving was the desire to increase capital and operating expenses for their farming. The third, most important motive mentioned by 17.3 percent of respondents, was to prepare themselves for educational expenses of their children. The fourth, mentioned by 10.1 percent of the respondents, was the desire to repay their debts.

TABLE 3 Motives to Save of Korean Farm Households

Motives to save	Number of respondents	Percentage
Unexpected surplus of family budget or prepareing for unforeseeable future	326	29.7
Increasing farm capital and expenses	239	21.7
Preparing for childrens' education	190	17.3
Repayment of debts	111	10.1
Others	232	21.1
Total	1,098	100.0

Source: Seol K. E, C. N. G, *An Analysis for the Supply System of Korean Agricultural Credit*, KREI, 1988.

Various sources from which farmers can borrow in rural Korea are classified into four categories: (a) various kinds of government subsidized poilcy loans that are usually provided by the agricultural and livestock cooperatives; (b) mutual savings loan mainly provided by the primary agricultural and livestock cooperatives; (c) private loans provided by individual lender; and (d) others which include commercial banks and insurance companies.

These four different borrowing sources may be classified into two categories, namely, institutional and non-institutional sources. Government loans, mutual savings loans and others are classified as institutional loans because those are supplied by the institutions. On the other hand, private loans are supplied by individuals or by the non-institutional lenders.

In rural Korea, the sources of borrowings have changed significantly since 1975. As shown in Table 4, the share of institutional loans increased from 34.5% in 1975 to 78.5% in 1987. The reasons of such increase are as follows: (a) the government had provided more policy loans in the 1980s than before: and (b) the amounts of mutual savings deposited at the financial institutions have increased rapidly during 1980s because large number of financial institutions were set up in rural areas, and the behavior of farm household savings had changed in this period. According to the statistics compiled by the government, the number of the primary agricultural and livestock cooperatives, and the mutual savings and credit unions located in rural area was 111 and 234 in 1975, whereas it was 1,911 and 463, respectively in 1987. Concerning the form of farm household savings, Korean farmers have changed their preferences from holding cash to financial deposits. In 1975, about 38 percent of farm households financial assets were held in cash while it was 8 percent in 1987. Nevertheless the share of time and demand depostits in total financial assets of the farm household increased from 22 percent in 1975 to 60 percent in 1987.

It is genernally observed that the main purpose of borrowings is to finance farm operating expenses, capital investment and household expenditures, and the repayment of debts. However, the objectives of borrowings have changed

TABLE 4 Changes of the Sources of Borrowings and uses of Borrowing of Korean Farm Household, Selected Year

Year	Sources					Uses			
	Govern-ment loans	Mutual savings loans	Private loans	Others	Total	Farm operating expenses and capital investment	Household consumption expenditure	Repay-ment of debts	Total
					%				%
1975	19.9	8.9	65.5	5.7	100	57.6	36.4	6.1	100
1980	28.8	19.8	49.0	2.3	100	60.8	33.0	6.2	100
1985	35.7	30.3	28.8	5.1	100	64.5	23.5	12.0	100
1987	34.6	37.3	21.5	6.6	100	60.5	22.3	17.2	100

Source: Suh, C. H, S. J. Park, ***Demand for Intermediate- and Long-term Fram Credit in Korea***, KREI, 1988.

since 1975. In 1975 about 36.4 percent of borrowings were to finance household consumption expenditures, but it decreased to 22.3 percent in 1987 because of increasing share of debt repayments. As mentioned previously, the amount of farm debts has been increased almost seven times during the 1980-1987 period.

2. Institutions Providing Rural Financial Facilities

There are many kinds of financial institutions which supply credit to, and accept from local residents in rural Korea. They can be broadly classified into four categories. namely: (a) agricultural and livestock cooperatives; (b) mutual savings and finance companies and credit unions; (c) commercial banks; and (d) postal office.

Agricultural and livestock cooperatives include primary agricultural cooperatives at Myun (township) level, and agricultural and livestock cooperatives at Gun (county) level. They are engaged in direct lending to farmers and deposit taking not only from farm households but also from non-farm households.

Mutual savings and finance company and credit union are classified as the second type of financial institutions. Village banks (usually called Saemaul Kumgo) are also included in this category. Along with primary agricultural cooperative and Gun-level livestock cooperatives these three institutions were established under the Credit Cooperative Act of 1972. The objectives of this Act were to mobilize households savings within a certain region, and provide credit to their members who need credit for both agricultural and livings purposes. Annual interest rates both on lending and deposit at these institutions are higher by one or two percent than those at commercial banks, but lower than those of private loans.

Local commercial banks were established in the late 1960s. However, most of local banks have opened during the 1980s when Korean Government chose a policy to promote local financial market and develop regional economy. Accordingly they are providing loans mainly to the local business sector. The post office is included in the financial institutions since it acts as a credit agency in mobilizing funds. However, lending activity is not conducted by this institution because such activity is prohibited by law.

Most of loans provided to farm household are supplied either by Gun agricultural cooperative or by the primary agricultural and livestock cooperatives since they are the only financial institutions to supply government policy loans to agricultural sector. Moreover, the share of deposit taken by them is more than 50 percent of total deposit in rural Korea.

III. Government Policies and Programs for Savings Mobilization

Between 1980 to 1986 mobilizing domestic savings was one of the major economic policy goals in Korea. Increasing capital formation was necessary for a sustained economic growth in this period. Korea could increase its capital formation in two ways: it could either increase its domestic savings or secure capital from external sources by attracting foreign equity investment in capital assets by borrowing on conventional terms from foreign governments or international financial institutions. However, it was very difficult for Korea to secure foreign capital during the 1980~1987 period because the international balance of payment of Korea was negative, and it was one of the countries that had large amounts of foreign debts.

Consequently the Korean Government had to introduce more measures aimed at mobilizing additional personal savings for a continuous economic development. New institutions have been set up and existing ones strengthened. Moreover new savings instruments have been designed and an array of incentives have been introduced in the 1980s. Among many government policy programmes, higher rates of return and tax incentives on household savings, strengthening government supervision on many small financial institutions, and setting up many local banks in rural area were noteworthy. The incentives involving higher rates of return on savings include attractive rates of interest and tax privileges.

Broadly speaking, there are two kinds of deposits, namely, demand deposit and time and savings deposit. Generally, the interest rates paid to demand deposit is lower than time and savings deposit because the latter can be easily withdrawn by the depositors. Also the depositors uses this account by means of cheques drawn on the account and payable through the bank. On the other hand, time and saving deposits are deposits for which the term of the deposits is fixed, and which in principle can not be withdrawn during the contract period. The current deposits and the household checking deposits are classified as demand deposits, while the time deposits, the installment savings and the preferential savings deposits are included in time and savings deposits in Korea.

Among the various kinds of deposits mentioned above, the preferential savings deposits have contributed much to personal savings during the 1980s. These savings deposits are allowed only to household's savings but limited to one account per household. Also, the amount of deposit cannot exceed 20 million wons. It has some advantages to the depositors. The depositor may freely deposit and withdraw his savings after three months, a minimum period of deposits. Moreover, the interest rate paid to the depositor is slightly higher than that on time deposits.

Another type of deposits introduced in the early 1980s, which contributed much to personal savings, is the workmans property formation deposits. These deposits were originally designed to increase savings from the middle- and low-income class wage earners and farmers. Accordingly a higher interest rate (usually three to five percentage more than ordinary deposits) is paid on deposits of more than three years. Also a lower income tax rate is applied to the interests paid to this type of deposits.

Another successful government program for mobilizing domestic savings was to set up several local commercial banks in rural areas, and to strengthen the second type financial institutions.

To mobilize local funds, Korean Government allowed to establish a local commercial bank in each province from early 1980s. As a result, many branches of the local commercial bank were opened in rural area (mostly at the center of each county), and collected local deposits. The number of commercial banks increased rapidly in the 1980s and contributed much to supply loans to local industries. In 1987, the share of deposits at these institution was about 10 percent of national bank deposits.

Agricultural and livestock cooperatives, credit union, Saemaul Kumgo (village bank) and mutual savings and company are the most common financial institutions in rural Korea. They were established under the Credit Cooperative Act of 1972 and the Mutual Savings and Financing Co. Act. They specialize in the granting of personal savings to their members, and can therefore be considered essentially as a consumer-producer type of credit organization in Korea. Since they are characterized by small and independent banks, security of deposits is lowly regarded by customers even though a higher interest rate is paid on their deposits. Actually, there had been many untoward accidents such as insolvency and liquidation crises encountered by this type of financial institutions during the 1970s.

To prevent these financial institutions from insolvency, and to save depositors from banks failures, government supervision has been strengthened from the late 1970s to the early 1980s. These institutions were audited intensively by government as well as national association of these institutions. Moreover, special funds were established to meet bank insolvency.

Higher rates of return on savings are one of the incentives to the depositors. Whether this has achieved its intended deffects is indeed questionable in case of Korea. Within a certain period of time it may be true that the depositors choose a deposit which pays higher rate of interests. As mentioned earlier, the preferential deposit offered to middle- and low-income workman and farm households has been successful in mobilizing domestic funds. However, there is no evidence that they might not deposit or save at all if there had not been such a preferential deposits in Korea.

On the other hand, there is some evidence that savings are not always interest-elastic in Korea. According to Hyun and Kim (1978), the annual growth rate of savings deposited at the primary agricultural cooperatives was about 68–80 percent during the 1974–1978 period, despite the fact that the real interest rates of the mutual credit (a common deposits at these institutions) were negative. Moreover, a recent study conducted by Suh and Park (1988) showed that in choosing a financial institution for their deposit, famers consider their personal relationship with bank officers more important than other factors. Only 9 percent of the respondents in the said study agreed to change their deposit institutions if an additional one percent interest rate is offered by other institutions. Also, it was found in their empirical analysis that the interest rate elasticity of saving is close to zero.

IV. Suggested Measures

The Korean experience seems to suggest that the principal requirement for mobilizing rural savings is to establish an effective linkage between the organized financial institutions and the informal systems of mobilizing rural savings. The mutual credit system in Korea is a good example. Another requisite for a successful rural savings mobilization is to change farmers attitude toward savings. As pointed out in previous discussions a large portion of farm household expenditures was used for social activities such as marriage, birthday and funeral ceremonies. In rural Korea, most farmers give a higher priority to such social activities.

There are several constraints to implement policy programs aimed at rural savings mobilization. Inflationary pressure is one of the important constraints which deteriorate rural savings capacity, hence policy programs. When the real interest rate on deposits was negative and farmers had difficulty accessing credit, the APS were usually low in Korea.

The Transfer of mobilized rural savings to urban area is another constraint to implement government policies. In many cases large size farmers invest their accumulated savings in non-farm related investment outlets such as purchasing bonds or house in urban area. Therefore, the government has to supply more subsidized policy loans to the agricultural sector despite the fact that many farmers deposit or invest their surplus funds in the non-farm sector.

Among many national policies, the regulated interest rates policy undermines most the performance of rural financial market. Since the regulated interest rates is usually lower than that of the private financial market, farmers are less willing to deposit at the institutional organizations. As a result a dual financial market is inevitable in rural areas.

The policy of promoting postal savings system is also undermines the rural financial market. Since savings deposited at postal office could not be lent out to local business or the farm sector, it only contributes to the outflow of local funds to urban or other sectors.

Considering the above-mentioned defects of government intervention in rural financial markets, commercial banks or farmers cooperative credit system are deemed more suitable than government-owned financial institutions in providing rural financial services. However, it does not mean that the inefficiency of government-owned financial institutions is highly related to its subsidized policy loans to the farm sector, nor that the government subsidized loans are not necessary to develop the agricultural sector.

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