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BRITISH COLUMBIA BUSINESS INDICATORS

December 1994

Personal Income and Savings Rates

The Sources and Disposition of Personal Income Have Changed Since 1961

The relationship between personal income and savings is one of the key economic indicators reported in the income and expenditure accounts. Personal income (the total of labour, transfer and unincorporated business income) may either be saved, used to purchase goods and services, or transferred to other individuals, corporations or the government. In turn, the savings of the personal sector[1] permit investment and borrowing by businesses and governments. Changes in the savings patterns of individuals can therefore have important consequences for private and public sector borrowers.

Savings are affected by factors such as general economic conditions, age, and individual preferences. However, income is probably the most important determinant of the savings behaviour of individuals. This paper first looks at changes in the sources and disposition of personal income during the last three decades, and then examines trends in the savings rate since 1961.

As Figure 1 illustrates, most of the income accruing to indviduals is in the form of wages, salaries and employer contributions to pension and other social insurance programs. In 1961 (the first year for which provincial data are available), labour income

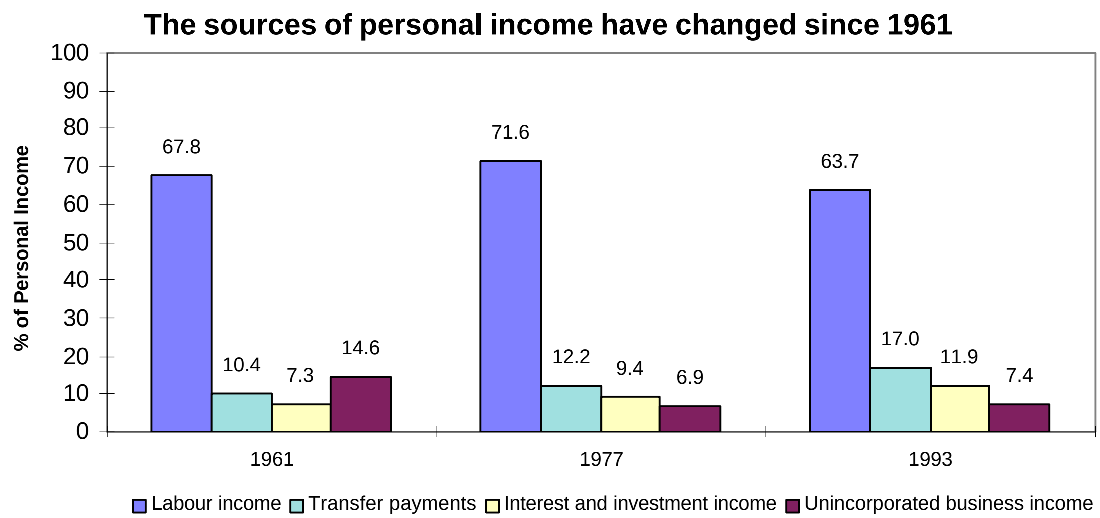

Figure 1

1 Individuals, unincorporated businesses and societies.

accounted for 67.8% of total personal income, and despite some fluctuations during the last three decades, it continues to comprise roughly two-thirds of the total income of the personal sector.

However, the relative size of the other components of personal income has changed significantly since 1961. Transfer payments (such as unemployment insurance and social assistance) have become an increasingly important source of income, making up 17.0% of the total in 1993, compared to 10.4% in 1961. Interest and investment income has also grown from 7.3% to 11.9% of total income between 1961 and 1993. In contrast, despite increases in the number of small businesses in the province, the income of unincorporated business operators accounted for only half as much of total personal income (7.4%) in 1993 as it did in 1961 (14.6%).

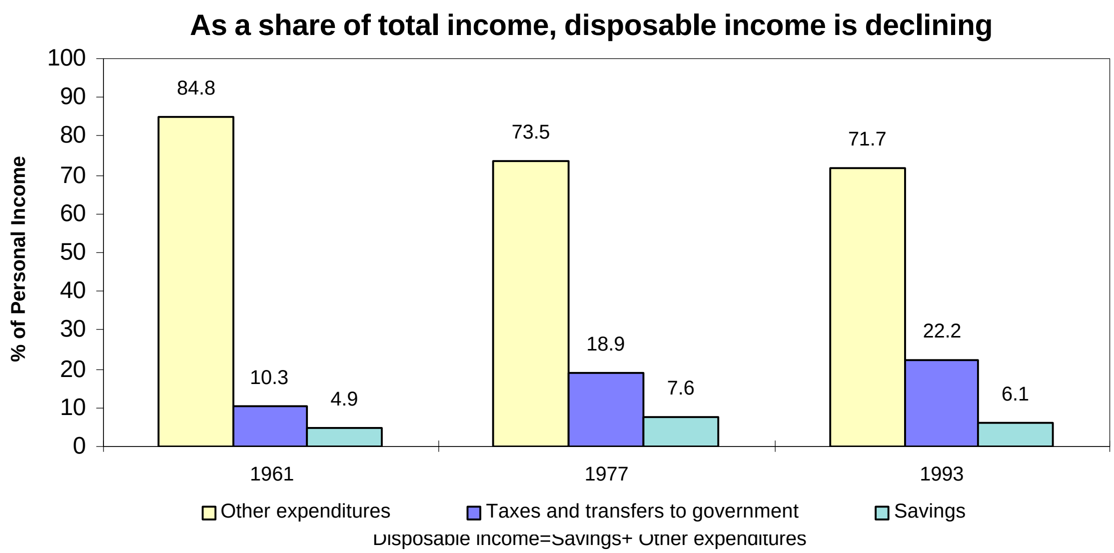

Figure 2

Along with the changes in the composition of personal income, there have also been shifts in its disposition. As Figure 2 illustrates, income taxes and other transfers to government (such as premiums for medical insurance) account for a growing share of total income, and as a result, there is less disposable income (i.e. personal income less taxes) for consumers to either spend or save. In 1961, taxes and transfers to government made up only 10.3% of total personal income but by 1993, the share had more than doubled to 22.2%. Most of this growth occurred between 1961 and 1969, when taxes increased from 10.3% to 18.2% of personal income. The government's share of personal income remained at about 18% until 1985, but increased to its current level of around 22% between 1985 and 1990. However, increases in taxes are by no means unique to British Columbia. Similar changes have occurred in other parts of the country.

With decreases in the percentage of personal income retained by consumers (disposable income) over time, one might wonder whether there has been an effect on the savings rate of British Columbians. However, as Figure 3 on the following page illustrates, between 1961 and 1993, British Columbia's savings[2] rate (the percentage of *disposable* income which is saved) increased from 5.4% to 7.8%, even though the share of disposable income in total income declined from 89.7% to 77.8%. Over shorter periods, however, it appears that there may be a relationship between the savings rate and changes in disposable income. For example, between 1961 and 1971, when disposable income declined in relative terms, the savings rate also fell sharply.

2 It should be noted that prior to 1981, net expenditures abroad were not explictly included in personal expenditure, and as a result, provincial savings rates for the years prior to 1981 may be either over- or under-stated, depending on whether net expenditures outside the province were negative or positive.

BC's savings rate has increased since 1961

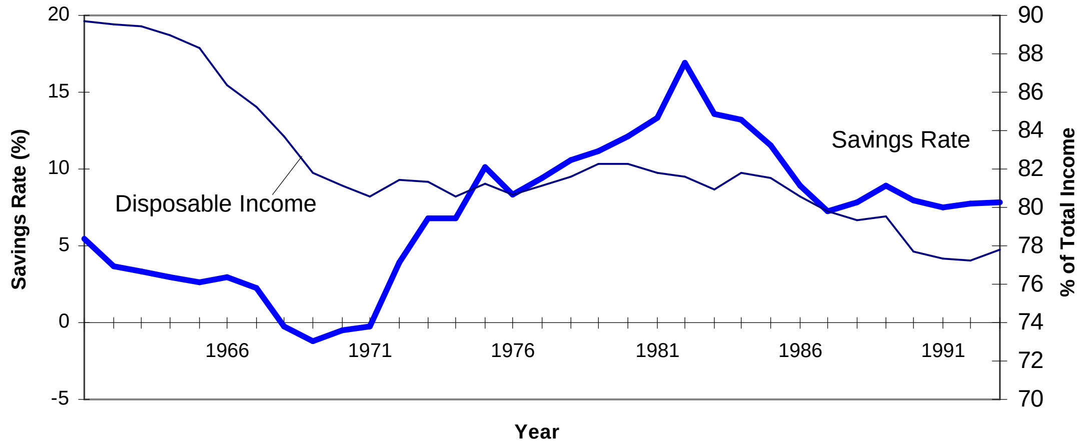

Figure 3

What Causes Changes in Savings Rates?

What causes the savings rate to shift over time? Changes in behaviour may be related to factors such as economic growth, unemployment, interest, and inflation rates, all of which can affect consumer confidence in the economy. Other influences such as the average age of the population (young people tend to be less likely to save than those who are middle-aged, while seniors generally dissave) may also result in changes to savings rates over time. Tax policies such as provisions for RRSP's and the treatment of investment income will also have an effect on savings rates. This section examines two of these factors, unemployment and interest rates, as they relate to the savings of British Columbians.

Figure 4 shows that there is a positive correlation between changes in the unemployment rate, which may be used as a proxy for general economic conditions, and the savings rate. Although periods of high unemployment often lead to dissaving by individuals who find themselves out of work, this effect is counteracted by more cautious behaviour on the part of those who are still employed. During periods of slow or negative economic growth, consumers who fear the loss of their jobs may choose to defer large

The savings rate tends to increase when the unemployment rate rises

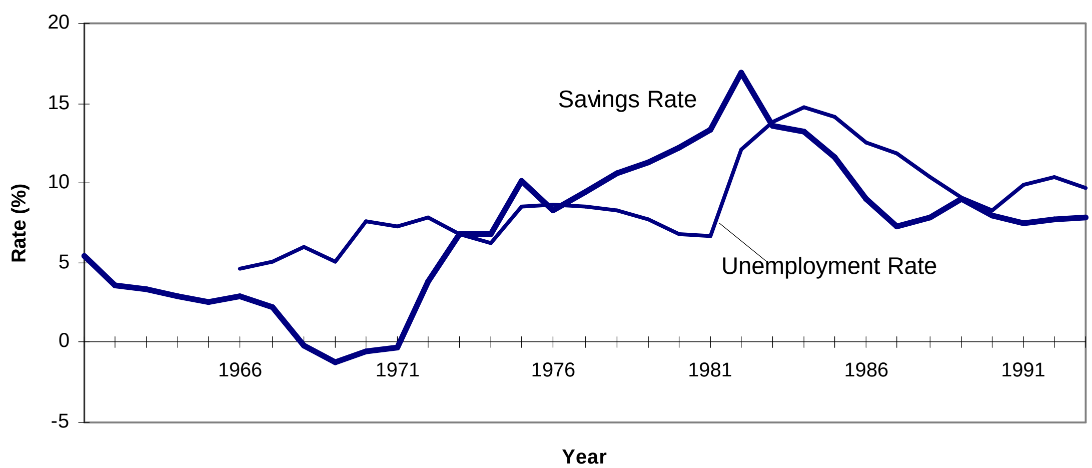

Figure 4

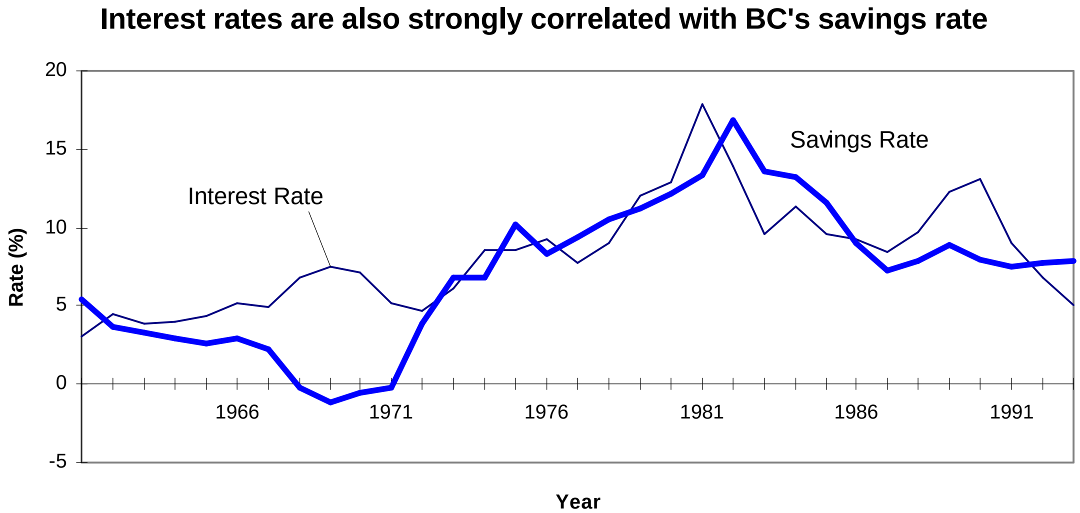

Figure 5

purchases and instead increase their saving in order to protect themselves from some of the economic costs of unemployment. Conversely, when the economy is growing and unemployment rates decline, consumer confidence generally improves and purchases of housing and durable goods tend to increase.

Not surprisingly, interest rates are also quite strongly correlated with the savings rate, as Figure 5 illustrates. Increases in interest rates tend to affect consumer saving in two ways: first, because consumers may be more inclined to save if they can get a higher return on their money, and second, because as interest rates increase, consumers are more likely to defer their purchases of homes, vehicles and other high-priced items until the cost of borrowing to finance these purchases decreases.

British Columbians Tend to Save Less Than Other Canadians

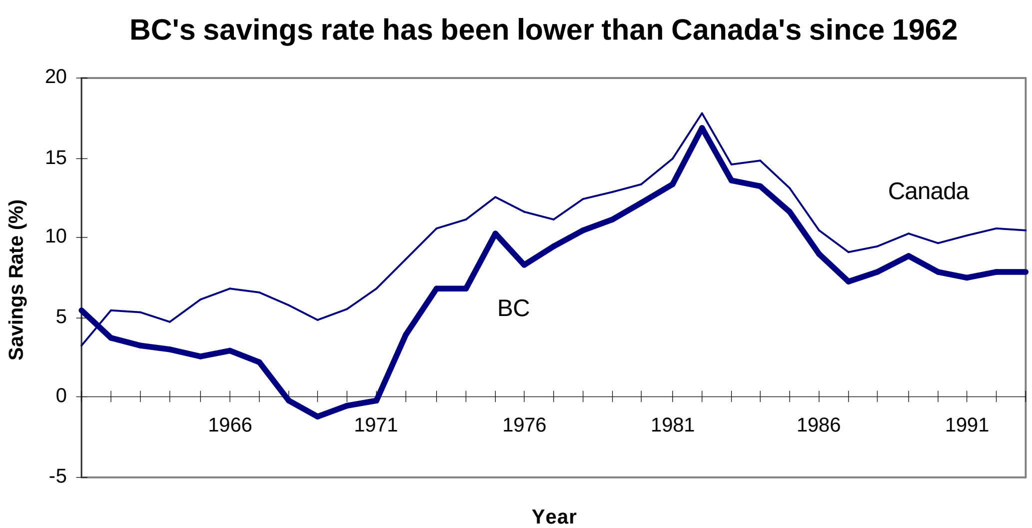

Figure 6

Although the province's savings rate increased between 1961 and 1993, British Columbians have consistently lagged behind other Canadians in terms of how much of their disposable income is saved, as Figure 6 shows. In all but one of the years since 1962, British Columbia was ranked fifth or lower among the ten provinces in terms of its savings rate and since 1991, only Nova Scotia and New Brunswick have had lower savings rates. The Prairie provinces and Ontario have generally tended to have above-average savings rates.

However, even though British Columbians save proportionally less than other Canadians, savings rates in this province have tended to follow upward and downward movements in the Canadian rate.

One possible explanation for the difference between savings rates in British Columbia and Canada could be that on a per capita basis, personal income in this province has been growing less rapidly than in the rest of the country. As Figure 7 shows, in 1961 per capita income in British Columbia was 15% above the Canadian average. Since then, the relative size of average incomes in the province has declined and in the mid-1980's, per capita income in British Columbia fell below the Canadian average. By 1993, however, per capita personal income in British Columbia had increased to 4.8% above the national average, while disposable income was 5.7% above the Canadian level.

Although British Columbians have consistently tended to save less than other Canadians, changes in the savings rate have generally followed the Canadian pattern fairly closely. While interest and unemployment rates clearly affect the pattern of savings, other influences such as slower growth in personal income, a different age structure of the population, and higher consumer prices may explain some of the variation between this province and the rest of Canada.

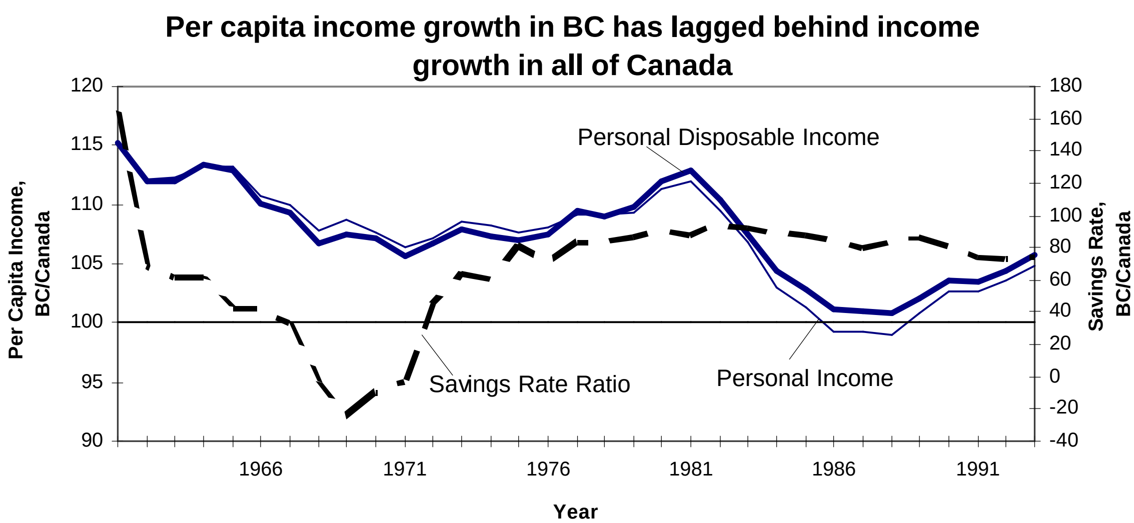

Figure 7