Researchers
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Timeline
2009

Sample Size
779 married couples

Research Implemented by IPA
Yes

Interest Rate Subsidies and Savings Behavior in Kenya

Abstract

The vast majority of the world's poor save, yet they often do so informally even when research findings suggest that accessing savings accounts at formal institutions can help low-income households increase their savings, investments, and ultimately their income. Could temporary interest rate incentives increase formal account use among the poor? A randomized evaluation in rural Kenya found that offering higher short-term interest rates on a savings account substantially increased bank account use two and a half years for after the promotional rate ended. Offering the interest rate promotion on individual bank accounts also increased household income via growth in entrepreneurship, while offering the promotion on joint bank accounts increased investment in household goods and led to greater spousal agreement on financial matters.

Policy Issue

The vast majority of the world's poor lack access to formal financial services. Recent estimates suggest that 80 percent of individuals in Sub-Saharan Africa are unbanked.[1] Yet this lack of access does not reflect an inability or unwillingness among households to save. Instead, low-income households in developing countries tend to save informally, often by keeping money with informal deposit collectors or saving cash at home, even though doing so can be quite costly.[2] At the same time, a growing body of literature suggests that increasing access to the formal financial services, and access to savings products in particular, can increase savings, investment, and income.[3] Understanding why households find saving so difficult and how to address the challenges is an important policy question. Short-term, promotional incentives may be one way to trigger changes in savings habits, but there is limited research into actual effectiveness.

Context of the Evaluation

Many people in Western Kenya save, but few do so formally. At baseline just 22 percent of study participants had a bank account, but nearly all participants saved in some fashion—87 percent saved in cash at home and 58 percent saved through an informal savings and credit association.

Before the evaluation began, Family Bank, a formal bank in Kenya that offers financial products tailored to the needs of lower income savers, started offering new, low-fee accounts. Like most bank accounts on the market, however, the account did not offer any interest on deposits, which, given the inflation rate in Kenya, means money not earning interest loses purchasing value over time.

Details of the Intervention

To evaluate the impact of temporary incentives to save, researchers gave 779 low-income married couples, recruited from rural and semi-rural areas near Family Bank's Busia branch in Western Province, the opportunity to open up to three bank accounts: a joint account, an individual account for the husband, and/or an individual account for the wife. Before the offer, each account was randomly assigned to qualify for one of four temporary, six-month interest rates: 0, 4, 12, or 20 percent (annually). The interest rates were purposely chosen to exceed market rates by a large margin, with the hope that they would encourage account use and increase savings. After the six-month interest rate expired, researchers measured take-up, account use, savings behavior, and economic impacts for individual and joint account holders. Researchers measured the same outcomes again after another two and a half years to understand the long-term effects of the interest rate subsidies.

Results and Policy Lessons

Take-up: Altogether, the 779 couples opened 1,152 bank accounts. While very few couples chose to open all three bank accounts, all couples opened at least one account.

Impacts on bank account use: Participants were more likely to open and use accounts that featured subsidized interest rates— just 31 percent of participants opened an individual account that earned no interest, while nearly half of participants opened this type of account when it received 20 percent interest. Receiving the highest interest rate offer increased the probability of making at least one transaction in an individual account within the six-month subsidy period by 9 percentage points (from a base of 6 percent in the comparison group), and more than quadrupled total deposits over the course of the first six months (an effect of Ksh 625, or US$7.81).

In the long-run, the vast majority of study participants stopped using the accounts—just three percent of individual accounts (8 percent of individual accounts that were actually opened) and five percent of joint accounts (8 percent of opened accounts) were used in the third year after opening.

Long-run economic impacts: Study participants that received the highest individual interest rate saved just Ksh 110 more in their bank accounts over the 6-month subsidy period, but in the long run the individual interest rate increased monthly individual business profit by $6.85 and business capital by $33, compared to those without the subsidy.

The gains in assets were driven by growth in entrepreneurship—participants who received the highest interest subsidy on their individual account were 11 percentage points more likely to be entrepreneurs and had substantially more business profits and capital two and a half years after the subsidy ended.

In contrast, the joint interest rate did not have an impact on overall income or assets. It did increase investment in household assets such as home renovations and livestock. Couples who received higher joint interest rates also reported greater levels of spousal agreement regarding consumption and savings decisions.

Sources

[1] Chaia, Alberto, Aparna Dalal, Tony Goland, Maria Jose Gonzalez, Jonathan Morduch, and Robert Schiff. "Half the world is unbanked (Financial access initiative framing note)." New York, Cambridge, New Haven (2009).

[2] Collins, Daryl, Jonathan Morduch, Stuart Rutherford, and Orlanda Ruthven.Portfolios of the poor: how the world's poor live on $2 a day. Princeton University Press, 2009.

[3] E.g. Ashraf, N., D. Karlan, and W. Yin. Tying Odysseus to the Mast: Evidence from a Commitment Savings Product in the Philippines. No. 121 (2), 635–672. Quarterly Journal of Economics. 2006; Dupas, Pascaline, and Jonathan Robinson. Savings constraints and microenterprise development: Evidence from a field experiment in Kenya. No. 5 (1), 163–192. National Bureau of Economic Research, 2013.

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