Govt rebates: Spend or save?

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What would you do if the Government gave you a pot of money? Is it better from an economic point of view to save or spend it?

Everybody loves free money, especially getting money back from the Government. We all wish there were helicopter drops of free money on a regular basis. However, in reality, we get free money very rarely. So, the question is: What do we do with it? Do we spend it or save it?

If policymakers intend the measure to stimulate the economy, then it is important to know how consumers will react.

In a recent example, the Ministry of Finance announced during the annual Budget speech on Feb 18, 2011 that as an attempt to share the nation’s economic growth in the previous year, the Government had decided to pay Growth Dividends to all adult Singaporeans aged 21 and above.

The amount each Singaporean received depended on his wealth. On average, 80 per cent of all Singaporeans received between $500 and $700 in Growth Dividends.

The package was designed to share the Budget surplus with Singaporeans, while providing redress to lower- and middle-income citizens.

Economic theory suggests that if you give households free money, they will not necessarily spend it. Most are likely to save it instead. In surveys, people also say that they will save the money or use the money to pay down debt.

Human nature dictates that survey respondents like to appear financially responsible. In reality, if you “follow the money” through credit and debit card spending and credit card debt, you will find that people are more likely to spend it.

In a recent exercise, my colleague Weitian Cian and I looked at the spending and debt response to the Growth Dividends package. We used a representative sample of more than 180,000 consumers in Singapore and studied how their spending behaviour on their credit card, debit card and bank checking accounts responded to this positive income shock.

We have a number of interesting findings.

First, the consumption by consumers rose significantly after the announcement and disbursement. For each dollar received, consumers on average spent 60 cents (aggregated across different financial accounts) during the 10 months after the announcement. Credit card debt experienced a moderate decrease.

Second, we found a strong “announcement effect”. Consumers started to increase their spending during the two-month period before the cash payout.

Third, the consumption response was concentrated in debit card and credit card spending.

Fourth, we did not find any significant change in the number of debit transactions in checking accounts as captured by ATM usage, branch and online transactions. This suggests that the majority of spending happened through credit and debit card spending.

Looking at the results more closely, we found that consumers started spending by using credit cards immediately after the Government made the announcement and switched to debit cards after the disbursement, before turning once again to credit card use.

Consistently, credit card debt dropped in the first months after the disbursement, then reverted back to the original level.

Lastly, consumption response varied across spending categories and individuals. Consumption rose primarily in the non-food, discretionary category. It also rose for low-income households. Young, unmarried, non-university-educated and possibly liquidity-constrained consumers responded most strongly with increased debt card spending.

Specifically, we found that:

■ Low-income consumers reacted strongly to the stimulus programme.

■ Low-income consumers spent 20 cents for every dollar they received on their debit card, and 61 cents for every dollar they received on their credit cards.

■ High-income consumers, on the other hand, did not increase their spending at all.

■ Young consumers spent 35 cents of every dollar received on their debit cards, and 73 cents of every dollar on their credit cards.

■ Older consumers did not increase their debit card spending significantly. But they did spend 71 cents of every dollar received on their credit cards.

Our results have implications for future policy actions of the Government in Singapore and elsewhere.

The key question is whether this is a good way for the Government to use the surplus. The economist in me says that taxpayers should receive part of the fiscal surplus whenever possible. But, who should receive this money is important. Our results show that, as expected, low-income households spend the money, while high-income households save it.

In the future, the Government should aim stimulus programmes at low-income households.

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