AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON, D. C. 20523
BIBLIOGRAPHIC INPUT SHEET

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Batch 62

1. SUBJECT CLASSIFICATION
A. PRIMARY
Food production and nutrition — AE10-0000-0000
B. SECONDARY
Agricultural economics

2. TITLE AND SUBTITLE
Mobilizing financial savings among rural poor

3. AUTHOR(S)
Adams,D.W.

4. DOCUMENT DATE	5. NUMBER OF PAGES	6. ARC NUMBER
1975	24p.	ARC

7. REFERENCE ORGANIZATION NAME AND ADDRESS
AID/TA/RD

8. SUPPLEMENTARY NOTES *(Sponsoring Organization, Publishers, Availability)*

9. ABSTRACT

10. CONTROL NUMBER
PN-AAD-814

11. PRICE OF DOCUMENT

12. DESCRIPTORS
Exploitation
Rural areas
Savings

13. PROJECT NUMBER

14. CONTRACT NUMBER
AID/TA/RD

15. TYPE OF DOCUMENT

AID 590-1 (4-74)

March 21, 1975

Mobilizing Financial Savings Among Rural Poor

by

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During the past three decades many parts of the world have experienced unparalleled increases in agricultural output. Even desperately poor countries like Bolivia, Bangladesh and Ethiopia have participated in this increase. Only in a few isolated cases, however, has this increased output significantly eased rural poverty. In too many cases property ownership, incomes and access to public services are more concentrated now than before rapid growth began. It seems clear that major changes in development strategies will be necessary if significant inroads are to be made on rural poverty problems in the future.

It is unrealistic to expect that any single treatment will cure a complex problem like rural poorness. In some cases major changes in landownership, political power, etc., may be necessary before rural poverty can be eased. In many cases adjustments in well known growth promoting techniques and policies may be helpful. In the discussion which follows it will be argued that financial market policies may be prime candidates for adjustments which lead to a more equitable distribution of income. It has been pointed out elsewhere that low interest rate policies usually lead to a concentration of concessionally priced credit in the hands of the well-to-do in rural areas [1, 2, 14]. It has been less well recognized that these same policies also

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may have a strong impact, through savings activities, on income distribution. The discussion which follows attempts to shed light on this issue. It begins by clarifying assumptions generally held about rural savings in low income countries. This is followed by a review of the evidence available on rural savings capacities. The final portion of the paper suggests benefits which might be realized from mobilizing voluntary rural savings, and also briefly outlines several pieces of a strategy for mobilizing rural savings.

Rural Savings Assumptions

During the past three decades a good deal of attention has been given to the role of the rural sector in overall growth. Socialist as well as market-oriented planners have recongized the need to mobilize rural "surpluses" for use in other sectors. With few exceptions, involuntary methods of extracting "surpluses" have been emphasized. These include various forms of taxation, price manipulation, and outright expropriation. Since the early 1950s a number of economists also have argued for the need to transfer "surplus" labor from rural to urban areas as the principal way of accelerating the capital formation process. At a local level a number of cooperative organizations in most less developed countries (LDCs) have attempted to mobilize financial savings through required-share-purchases, compensatory balances, and other forced savings techniques. Only in a handful of cases, however, have policy makers in LDCs stressed voluntary methods of mobilizing rural financial savings.

In large part, savings mobilization strategies in the past have been built on several assumptions about stereotyped economic behavior in rural areas as well as extensions of Keynesian economic theory. Rural residents were assumed to be too poor and operate too close to minimum subsistence levels to be able to save. It has been further assumed that even if the poor did acquire additional income it would all go into expanded consumption; marginal as well as average propensities to consume were assumed to be very high. One can find these basic assumptions imbedded in most growth theories. In part, it is for this reason that development programs based on these theories attempt to move increased income flows or surpluses through either the state, or through capitalists who are assumed to have more satisfactory savings behavior. In addition, on the basis of Keynesian and post-Keynesian analysis, a number of economists have concluded that savings behavior is insensitive to financial incentives such as interest rates.

Evidence on Rural Savings Capacities

Compared to many other areas of economic inquiry, there are relatively few studies which shed light on these critical assumptions about rural savings. In part this is due to the lack of data needed to test these assumptions. Consumption-savings and income data for the households are costly and difficult to assemble. Savings as well as income are considered by most households to be privileged information. In many household surveys income and savings activities are underreported. Further, consumption activities occur in dibs and dabs and it is difficult for most households to accurately estimate these expenditures after the fact. Also, it is very expensive and time-consuming to assemble time series information on households which will allow the researcher to study the dynamics of consumption-savings behavior. It is for these reasons that researchers are forced to use household account data which were generated voluntarily in farm record keeping systems, or to do case studies in which close rapport is established with households and information is regularly collected. A few of these types of studies have recently been completed. Evidence from them, plus bits and pieces of information from other less detailed studies appear to indicate that voluntarily rural savings capacities in LDCs may be much larger than previously thought, and that rural savings behavior may be sensitive to various forms of economic incentives.

Evidence from Taiwan

A series of recently completed studies provide a fairly comprehensive review of rural savings capacities in Taiwan during the past couple of decades. Three factors make the Taiwan case most useful for analysis of savings behavior: first, a good deal of detailed information is available on farm-household consumption, savings, and production behavior. Some of this data can be linked so that individual rural household economic behavior can be traced over more than a decade. Second, analysis is facilitated because income and consumption activities among rural households in Taiwan have changed sharply over the past couple of decades. Third, Taiwan is one of only a few countries which has aggressively promoted a voluntary savings mobilization program. It is therefore possible to study how variations in incentives affected savings activities.

Especially during the 1950s, policy makers in Taiwan aggressively used interest rate adjustments on savings deposits as an anti-inflation technique [21]. Over the period 1953 to 1970 the real rates of interest paid on time deposits in Taiwan were negative in only two years, 1953 and 1960

Table 1: Average Propensities to Save Based on Taiwan Farm Record-keeping Data By Year and Economic Sub-groups, 1960-1970[a/]

	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970
1. All Households	.18	.19	.21	.23	.24	.24	.28	.24	.28	.12	.20
By Farm Size (Hectares)											
2. 0 - 1.00	.15	.14	.16	.21	.17	.18	.19	.19	.23	.07	.13
3. 1.01 - 2.00	.16	.21	.22	.21	.25	.26	.28	.25	.27	.10	.23
4. 2.00+	.28	.19	.26	.30	.32	.30	.39	.29	.34	.19	.24
By Household Dependency Ratio [b/]											
5. 0 - .5	.20	.19	.24	.24	.24	.23	.27	.22	.28	.10	.20
6. .5+	.16	.18	.17	.22	.23	.24	.29	.28	.27	.15	.22
By Ratio of Farm Income to Total Household Income [c/]											
7. 0 - .7	.09	.18	.24	.14	.16	.22	.22	.20	.23	.07	.14
8. .7+	.19	.19	.21	.25	.26	.24	.30	.26	.29	.15	.24
Total Number of Households	95	207	233	227	535	501	430	402	416	411	404

a/ The average propensity to save is one minus the ratio of total household consumption/total household income.

b/ The dependency ratio is defined as total number of people of less than 15 years of age or more than 60 years of age in the household divided by the total number in the household.

c/ Farm income is defined as net farm income. Total household income includes farm income plus net income derived from off-farm activities.

Source: [33, p. 80].

[43, p. 26]. That is, the nominal interest rate paid on deposits generally exceeded the rate of inflation. These attractive rates of return on savings deposits resulted in substantial increases in rural voluntary savings deposits in the widespread Farmers Associations as well as in Postal Savings facilities. Over the 1954 to 1970 period the value of financial deposits in Farmers' Associations increased from the equivalent of $5.6 million U.S. to over $124 million [3, p. 14]. In some periods the deposits in the Associations have exceeded the values of loans made. Some of the deposits therefore have been transferred to other segments of the economy through normal financial channels.

Recent analysis of farm record keeping data in Taiwan indicates that savings propensities have been remarkably high. As can be noted in Table 1, average propensities to save were generally above .20 for the 1960 to 1970 period. It can also be noted that even the households in the smallest farm size group, those with less than one hectare, saved a surprisingly high proportion of their incomes. The data in the table also suggest that the dependency ratio of the household has had no consistent relationship with average savings behavior, but that households which derive the largest proportion of their total income from farm operations generally save proportionall more. Although not shown in Table 1, marginal propensities to save ranged from roughly one-third to two-thirds through the various economic sub-groups throughout the decade [34]. Not surprisingly, these very high savings propensities were closely associated with sharp increases in cash holdings, in financial deposits, and in productive assets among the households analyzed.

Additional analysis of the farm record keeping data in Taiwan showed that household savings activities were closely related to the rate-of-return on household equity [7]. At the same time, rates-of-return to on-farm assets were found to be negatively associated with consumption. Households apparently saved more when faced with profitable investment possibilities. It appears that the changes in the rates-of-return to farm investments, as well as to financial deposits, are important factors helping to explain the substantial changes in rural household savings behavior in Taiwan over the past two decades [8].

The Korean Case

In September 1965 the Korean Monetary Board sharply increased the rates of interest applied to credit and financial deposits. Nominal interest rates on time deposits were raised to 30 percent per year. This resulted in real interest rates in excess of 8 percent being paid on financial savings from 1965 to 1971 [6, pp. 180-181]. These financial reforms caused huge increases in amounts of household financial savings as well as in numbers of time deposits from 1965 onward. Over the past ten years, financial savings on deposit in the National Agricultural Cooperative Federation increased at a much faster rate than farm income [30]. Part of this increase in financial savings appears to be due to the much higher rates-of-return offered financial savers starting in 1965.

Individual rural household savings behavior in Korea has not been analyzed in detail. A comparison of consumption and income information collected in annual farm household economic surveys, however, shows very sizeable average propensities to save. From 1965 to 1971 the average propensity to save among the households surveyed increased from less than .07 to .30 [28]. Part of this increased savings was likely due to expanded incomes and farm policy which gave farmers stronger inducements to defer consumption in favor of financial savings and investments in farming operations.

Evidence from Japan

As Kato has shown, since the early 1920s agricultural cooperatives in Japan have mobilized voluntary rural financial savings far in excess of the amount of agricultural loans extended [24, 25]. A large part of this "excess" savings has moved out of the rural sector via financial markets.

A number of detailed household level studies of rural consumption-savings behavior have been carried out in Japan over the past few years. Many of these studies rely on data collected through the Survey of Farm Household Economy. Without exception, these various studies have shown that rural households in Japan have had high average as well as marginal propensities to save [e.g., 5, 29, 32, 41]. Rural households with farming operations have had savings behavior very similar to that reported in the Taiwan studies.

Indian Evidence

A surprisingly large number of general studies of rural savings have been carried out in India [e.g., 20, 39]. As one might expect, rural savings capacities in India are not as great as those found in Taiwan, Korea and Japan. In part, this is due to lower income levels in rural areas of India. One might also argue that rural people in India have less incentive to save. In many areas returns to on-farm investments appear to be unattractive. Further, badly fragmented financial markets do not offer potential rural financial savers positive rates-of-return.

Despite these less favorable savings conditions, results from several studies indicate significant savings mobilization potential may exist in rural India. Panikar, for example, argues that rural families have substantial savings capacities and also have higher marginal propensities to save than do their urban counterparts [35]. Other studies conclude that the amount of financial deposits in rural areas may be closely related to interest rates paid on deposits [15, 16, 17, 37]. Still other authors conclude that substantial amounts of voluntary rural financial savings might be mobilized if secure financial services and facilities were more readily available in rural areas [4, 23]. On the basis of household level studies in one state of India, Desai and Desai conclude that substantial savings capacity may exist in India in rural areas which are experiencing growth [12]. Marginal propensities to save of .29 and .63 are reported in their study of two groups of rural households. Even the poorest households in rural India maintain some savings in gold and jewelry for emergencies. The huge amount of gold and jewelry held in rural areas is at least a partial indication that financial markets are functioning poorly

African Evidence

During the latter part of the 1960s the University of Nottingham carried out extended case studies in several areas of Zambia. A total of 239 households were regularly visited over a two-year period and detailed accounts were kept on important economic activities [38]. On the average, these accounts showed that rural households were saving more than 30 percent of their income. Relatively few of these savings filtered into the poorly developed financial market in Zambia, however. Recent increases in developing rural savings clubs in Zambia, Lesotho, Rhodesia and Malawi hint that significant savings capacities may exist in other parts of Africa [19].

In the past few years Uganda and Nigeria issued new currency. Holders of the old currency were forced to convert to new bills before a given date. Most policy makers were astounded by the huge amount of currency which came tumbling out of tin cans and mattresses in rural areas for conversion. As in Zambia, it appears that financial markets in Uganda and Nigeria are not providing adequate financial savings services in rural areas.

In Kenya, a coffee cooperative recently began to deposit members' receipts from sale of coffee in unblocked savings accounts [44]. Despite very modest interest rates paid on these deposits, the cooperatives were very surprised by the large amounts which were left on deposit. These deposits substantially exceeded the volume of funds lent by the cooperatives to their members. Some recent success in mobilizing savings through postal savings, savings banks, and credit-savings unions in Africa also provides some evidence that significant voluntary rural savings capacities may exist in Africa [11].

Other Evidence

Results from several forced savings programs in Nepal, Bangladesh, and the Philippines also suggest that substantial savings capacities exist even among the poorest and smallest landowners and tenants [26, 42]. The current Philippine experiment is particularly interesting. As part of a nationwide village organization program (Samahang Nayon) participants are required to transfer 5 percent of their bank and cooperative loans to a barrio savings account. In addition, participants are also required to turn over a given quantity of rice each year to a barrio guarantee fund. A special group life insurance program is financed from this guarantee fund. The amounts of resources being mobilized under these various savings programs are astounding. With part of these funds the Samahang Nayon has formed its own national insurance program as well as one bank.

The very rapid increases in voluntary savings deposits in rural private banks in South Vietnam during the past few years present further evidence on the savings capacity question [31]. Despite very trying circumstances, some of these private banks have been effective in increasing time deposits through special savings promotion programs. This has included lotteries, door-to-door advertising and soliciting, and pretty girls who promote savings among bank visitors.

A study of rural savings capacities cannot ignore the recent remarkable growth of the credit and savings cooperatives in Latin America [9]. A majority of these cooperatives service mainly urban areas. There is, nevertheless a significant number of these credit-savings cooperatives located in rural areas. Part of the savings are collected through required share purchases, but a significant amount is also deposited voluntarily [10].

Advantages from Voluntary Mobilization of Rural Savings

At this point, a skeptic might argue that even if some voluntary savings capacities do exist in rural areas, they are too costly to mobilize via financial markets, and that some other form of taxation is a more efficient way of mobilizin resources. As will be argued in the following, there are at least three strong reasons for stressing voluntary rural financial savings.

Strengthening Financial Markets

The first reason is that financial savings may be important to overall strengthening of financial markets. Until recently, most economists assumed that financial markets played a neutral, passive role in development. This view recently has been challenged [6, 27, 40, 45].[1] Based largely on the Korean and Taiwan experience Brown, McKinnon and Shaw have cogently argued that proper financial policies can provide some fundamental developmental pulses. Wai supports this position and goes on to argue that financial intermediation has a positive influence on national savings [45]. This new line of thinking places very heavy emphasis on the key role which adequate incentives play in inducing financial savings. Stress is also placed on how proper interest rate policies along with mobilization of financial savings help to integrate and substantially strengthen financial markets in general.

Filling the Institutional Gap

The Taiwan case suggests that mobilization of financial savings might also play an important part in strengthening local service organizations. For a number of years many less developed countries have tried to bridge the institutional gap in rural areas between national service organizations and the individual by building cooperatives and farmers associations. In many respects it is fortunate that these local organizations have been "bio-degradable'

[1] Earlier work by Goldsmith, and Gurley and Shaw [13, 18] laid the foundation for these arguments.

Otherwise, the landscape in most LDCs would be littered with defunct cooperatives and burned out farmers associations. Despite some modest success in a few countries, the experience with building these intermediate service organizations has been very disappointing.

A number of reasons have been suggested for this poor result. Some have argued that filling the institutional gap is a long run venture; participants' attitudes must be changed, laws must often be modified, and governments and policy makers must slowly learn to appreciate what these intermediate organization can do. I am sympathetic with the view that development planners often seriously underestimate the time needed to evolve viable service institutions for the rural poor. At the same time I feel there are some fundamental problems which need to be addressed before this type of institutional development has a reasonable chance of success. In all too many cases intermediate organizations are formed and burdened with economic functions in which they cannot compete. A cooperative, for example, may attempt to sell consumer goods to members in an area where dozens of competing merchants are selling similar goods on very small margins. Still other intermediate organizations may be formed to market participants' products, but find the existing competition, combined with wide swings in product prices, too much to tolerate. Some organizations have also been formed to sell small amounts of agricultural inputs to members, again under conditions where the organization cannot remain financially viable.

In the past, a number of these intermediate organizations have been asked to provide some financial services, mainly credit, to their members. Typically, these loans are granted at concessional rates of interest. These rates of interest are almost always below the opportunity costs of capital in the econor below the going commercial rate of interest in the money market, and often also below the rates charged on regular agricultural loans made by banks. Further, in a number of cases the rates of interest which intermediate organizations are allowed to charge are well below the rate of inflation. These concessional interest rates weaken the intermediate organization in three ways. First, the availability of concessionally priced credit makes the intermediate organization vulnerable to intrigue.[2] Low interest rates force intermediate organizations to ration "bargain credit." These non-market rationing decisions are highly exposed to various types of personal influence, political persuasion, and outright corruption. Second, concessional interest rates on credit almost always force an intermediate organization to concentrate its loans in the hands of relatively few borrowers. Part of this is due to the intrigue factor, but part is also due to the internal financial pressures within the intermediate organization. With an excess in demand for their loanable funds at concessional interest rates, lending agencies minimize lending costs by concentrating loans in the hands of relatively few borrowers. The lament that the large farmer captures most of the concessionally priced cooperative credit can be heard around the world.[3] The intrigue and the loan concentration process have obvious deleterious effects on the willingness of non-recipients of the bargain credit to participate in the intermediate organization.

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[2]For further discussion of this issue refer to [14].

[3]The economic benefits associated with obtaining this concessionally priced credit might be termined "rationing profits."

Third, concessional interest rates on credit make it next to impossible for intermediate organizations to maintain, let alone expand, the real value of funds which they have for lending. This is due to two factors: capital erosion due to inflation and loan defaults, and inability to offer strong interest rate incentives for members to voluntarily deposit funds in the organization. These two factors seriously undercut the ability of an intermediate organization to expand and integrate itself into the national financial system. Cooperatives and farmers associations are forced to live the uncertain life of a mendicant whose financial sustenance must come from beneficient central banks or foreign aid agencies. Mobilization of voluntary savings might allow these intermediate organizations to develop a much larger degree of independence and self sufficiency.

Discouraging Household Consumption

Although not generally recognized, financial market policies also may have a significant impact on the household consumption decisions and on the on-fa capital formation process. These relationships are a third reason for stressing savings mobilization programs in rural areas. Financial policies impinge on the firm-household decision making process in two ways. The first is via the generally recognized credit-connection. In some cases the liquid resources of the rural household are not sufficient to allow it to move to efficient levels of input use. Credit provided by the financial market provides the lubrication necessary to allow operators to apply more inputs, make more investments, and realize additional income. This additional income is then exposed to consumption-savings decisions.

It has been less well recognized that financial market policies directly affect household consumption-savings decisions via the incentives provided to financial savers.[4] Policy makers often forget that concessionally priced credit usually forces financial institutions to offer potential as well as actual financial savers little or no reward for postponing consumption via financial savings. It is little wonder that banks in rural areas of countries like Colombia, India, Kenya and Brazil attract very few savings deposits when they offer real rates of interest which are negative.

A Savings Mobilization Strategy

In order for financial markets to play a positive role in the resolution of rural poverty, some fundamental changes in policies in most LDCs will be necessary. Current policies are resulting in badly fragmented financial markets, in heavy concentration of concessionally priced credit in the hands of relatively few people, in unprofitable financial operations in many rural cooperatives, and in little or no positive incentive for rural households to defer consumption. Overall, these financial policies are very regressive in the way they affect rural income distributions: the relatively well off benefit from the concessionally priced credit, and the poor are denied access to production credit as well as remunerative savings instruments. Furthermore, perpetuation of fragmented financial markets results in too little honest competition between formal and informal financial markets. Under these conditions some informal credit sources are able to continue to extract

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[4] The financial incentives to save, of course, are only one of several different incentive signals which influence household consumption-savings decisions. The profitability of on-farm investments as well as non-financial off-farm investments may also influence household consumption decisions.

monopoly profits from small borrowers who are denied access to formal markets. A rationalization of financial market policies combined with aggressive saving mobilization programs would eliminate part of these undesirable features.

In large part a savings mobilization effort must be carried out at two levels. Some changes, for example, must be realized at a national level before substantial voluntary savings can be mobilized. In general these changes include a higher interest rate structure throughout much of the financial market. Where rates of inflation are above say 15 to 20 percent per year, financial savings instruments might be value-linked so that the principal value of the savings is tied to some type of price adjustment [42]. Additional inducements might also include tax changes which exempt interest payments on certain kinds of savings deposits from income tax. This has been done in Tunesia, Taiwan and a number of other countries.

It is often necessary to institute some legal changes so that cooperatives and other local organizations can legally handle credit and savings activities. In some cases it might also be necessary to adjust some laws and administrative procedures so that these local organizations can be integrated into regular financial markets. Bonding services on a nationwide basis for employees who handle financial activities in these local organizations would also be helpful. In addition, nationwide deposit insurance programs such as currently found in the United States, the Philippines, and Uganda are needed to assure savers of secure deposits.

At this point, a reader might comment that raising interest rates is great in theory, but politically impossible to carry out. Some politicians view concessionally priced credit as a way of buying political support. They forget, however that cheap credit policies lead directly to cheap savings policies and, further, that only those who get the concessionally priced credit feel its benefits. One might argue that on balance more votes would be positively influenced by high rates-of-return on savings deposits combined with wider availability of credit, than would be bought by concessionally-priced credit which is handed out to only a few.

Where at least part of the above mentioned conditions are present it is possible to initiate vigorous local savings mobilization programs. Fortunately, many of the less developed countries have at least a partial set of institutions already in place which can handle financial savings. In many countries including Colombia, Costa Rica, the Philippines, India, and Bangladesh a number of banks already provide some services in many rural areas. Postal savings offices, cooperatives which handle credit, and credit-savings unions dot much of the landscape in many other parts of the less developed world. A local savings mobilization effort, therefore, need not concern itself primarily with constructing new financial institutions. Initially, major emphasis should be placed on getting a balanced and economically sound set of financial activities in the institutions which already exist.

The exact makeup of a successful local savings mobilization program will vary from area to area by necessity. These programs might include various combinations of the following components: in some cases various types of forced savings programs may already be underway, or appropriate to initiate. Required share purchases in an organization, compensatory balances, regular contractual savings, and even depositing cash receipts in an unblocked savings account may be stressed in the start-up phase of a savings mobilization program. The mobilization efforts, however, early should begin to stress voluntary savings incentives. If the Taiwan, Korean and Japanese experiences are representative of what might occur under proper conditions, these voluntary savings should very soon make up the bulk of the savings mobilized.

As has already been mentioned, the key element in a savings mobilization program is the attractiveness of the reward paid on savings. Convenience, liquidity, and security of the savings, however, strongly complement the return paid. Where legal, a lottery attached to savings deposits may also promote additional interest in voluntary savings. A large number of countries including South Vietnam, Egypt, Sweden, Tunisia, Colombia, Russia, El Salvador, Iran, France and India already have some type of drawing associated with savings accounts. Cash as well as merchandise bonuses can also be provided to depositors In a few cases a life insurance option tied to savings deposits might also strengthen the incentive to save. This has been a popular feature in some credit-savings cooperatives in Latin America. As previously mentioned, life insurance in one of the rural development programs in the Philippines has been surprisingly popular.

Any savings mobilization effort will work better where agricultural growth and rural incomes are energized. A national savings program should, therefore, initially stress savings promotion in areas where agriculture is on the move. Above all, irregardless of where the program is started, it should be strongly supported and promoted. This includes rewards and recognition for organizations and managers which are most successful. The degree of ingenuity shown by South Vietnamese bankers in mobilizing savings, strongly suggests that creative new approaches emerge when incentives are adequate.

A Concluding Comment

Development from below appears to be the only way to effectively reach rural poor. The savings program briefly outlined above might be a first step in a bootstrap approach to rural development in LDCs. It would stimulate rural poor to increase their own capital base, it would provide a more healthy environment for local organizations to grow, and it would allow local financial institutions to integrate with regular financial markets. Current financial market policies in most LDCs are an unmitigated disaster for most rural poor. It is past time for policies to be adjusted so that rural poor are more fairly treated by this most important development instrument.

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