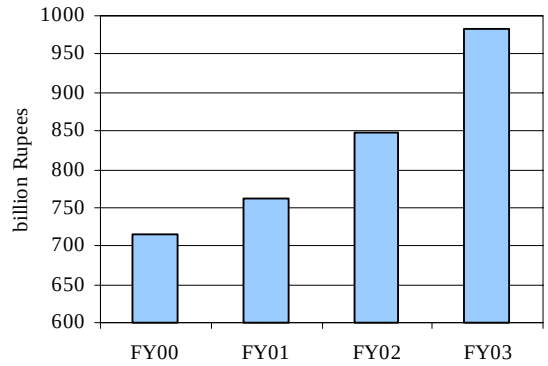
5 National Savings Schemes

Several measures were undertaken by the Central Directorate of National Savings (CDNS) to rationalize the national savings schemes (NSS) over the last three years. These included linkage of profit rates on major NSS instruments with PIB yield, levy of withholding tax on profits from these schemes and introduction of a new scheme specifically for the pensioners and widows. These measures together with the exceptional rise in workers' remittances and overall changes in interest rate structure led to substantial changes in funds mobilized from these schemes. Furthermore, net mobilizations from NSS remained an important source of deficit financing over the same period. Despite the positive implications of these measures, NSS remained an expensive source of deficit financing as compared to the banking sector.

More importantly, the dramatic fall in interest rates on government securities in response to discount rate cut in November 2002 together with ample liquidity with the banking sector, subsequent steep slide in lending rates and relatively higher rates of return on NSS created an interest arbitrage opportunity in the market during FY03. Both, investors and banks benefited from this opportunity at the expense of the national exchequer. As a result, the government was forced to suspend the sale of DSCs and SSCs through bank outlets with effect from June 16, 2003. How effective this suspension proves to be in practice, is yet to be seen.

Figure 5.1: Outstanding amount in NSS



As on end-June 2003, a very large outstanding amount of Rs 982.5 billion in NSS is enough to highlight its importance (see **Figure 5.1**). This outstanding amount constitutes 53.0 percent of domestic debt. It, therefore, has strong implications for debt management as well as the stability of financial system. Having said this, the importance of NSS and its related issues can hardly be over emphasized. Subsequent sections present an analysis of the role of NSS in financing budget deficit and its implication for the financial sector as a whole.[1]

5.1 Characteristics of NSS and Mobilization Trends

A major function of the NSS is to generate funds for the financing of budget deficits with a concomitant mobilization of savings in the economy. NSS meets financial investment needs of various investors including pensioners and small savers of lower income groups, particularly the fixed income group. Accordingly, CDNS is offering various non-tradable Savings Certificates/Schemes with different maturity profiles ranging from 3 to 10 years. Some of these schemes were specifically designed to meet the requirements of pensioners, widows, orphans etc. and only individuals are eligible to invest in these schemes.[2]

The profit rates on NSS were administratively controlled in the past and were subject to discretionary changes. In other words, there was no established market mechanism for determination of these rates. However, these rates have been linked with a market-based instrument PIB since FY00. Nevertheless, rates are generally differing according to their maturity period, mode of repayment of

[1] For a historic background of NSS, see **Chapter 4** of **Pakistan: Financial Sector Assessment 1999-2000**, SBP, 2002.
[2] Initially, institutions were allowed to invest in these schemes. However, all type of institutional investment has been barred since March 2000.

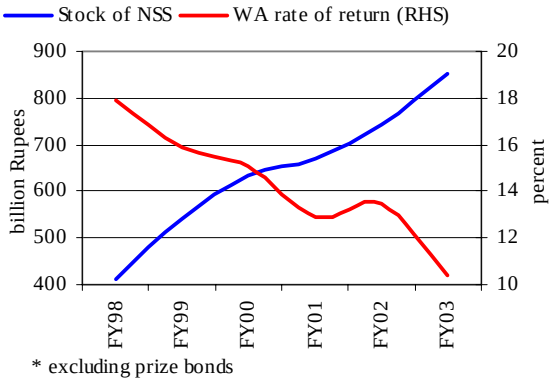
principal, frequency of profit payments, tax treatment etc. Furthermore, in the absence of secondary market for NSS, most of the certificates carry early encashment facility without any penalty (see **Table 5.1**).

In addition to medium and long-term certificates, the CDNS offers savings accounts both checkable and non-checkable. The profit on these accounts is credited once a year and there is a restriction on the frequency of withdrawal. The directorate also offers a bearer instrument, National Prize Bonds, to tap the savings of the informal sector. Recently, the CDNS has introduced a new account named Pensioners' Benefit Account during FY03.

Table 5.1: Major Characteristics of Selected NSS

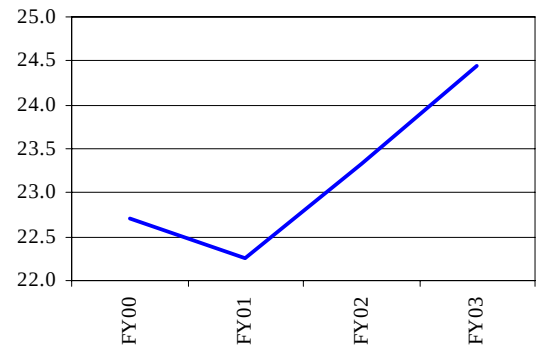
Characteristic	DSCs	SSCs	RICs
Maturity Period	10 Year	3 Year	5 Year
Minimum holding period	1 Month	1 Month	Nil
Early encashment penalty	Nil	Nil	1% to 4%
Profit Payments	Bullet Bond	Bi-annually	Monthly
Zakat	Compulsory	Compulsory	Voluntary
Withholding Tax	@10%	@10%	@10%
Tax Concession	Investment not exceeding Rs 150,000		Nil

Figure 5.2: Stock of NSS and Rate of Return on NSS*



Notwithstanding the gradual fall in profit rates of NSS, net outstanding amount in NSS surged up from Rs 761.7 billion in FY00 to Rs 982.5 billion by end-FY03, with an annual compound rate of 13.6 percent (see **Figure 5.2**).[3] Since this growth is higher than the growth in nominal GDP, the outstanding amount in terms of GDP also increased from 22.3 to 24.5 percent over the same period (see **Figure 5.3**). Relatively higher profit rates on NSS as compared to the competing instruments, and increase in workers' remittances are major contributing factors toward this higher growth. However, a slight dip in FY01 was the upshot of reduction in profit rates and imposition of tax on the profits from these schemes.

Figure 5.3: NSS as percent of GDP



Although overall net outstanding amount is of vital importance, monthly gross inflows in NSS also provide more interesting insights as: (1) it does not take into account the effect of repayments and premature encashment during the year, and (2) the effect of change in profit rates will be more visible in gross receipts. Gross inflows in NSS for the last three years are depicted in **Figure 5.4**.[4] The following points are worth noting about changes in gross inflows:

- Monthly gross inflows in NSS during FY01 did not record major changes and stayed around Rs 15 billion per month. Three successive cuts in profit rates during May 14, 1999 to July 1,

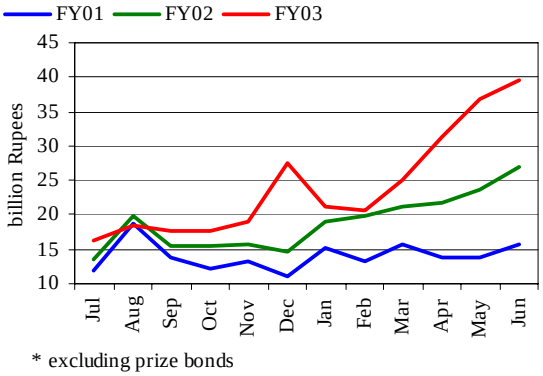
[3] In **Figure 5.2,** stock of prize bonds is excluded from the outstanding amount of NSS.
[4] Gross inflows do not include the Prize Bonds, as these are hardly determined by interest rates due to their very special nature.

2000 and relatively stable interest rate structure in the economy were the prime factors responsible for lower but stable inflows in these schemes.

- Inflows during H1-FY02 maintained an approximately similar trend as in FY01, as the effect of around one percentage increase in profit rates was offset by the imposition of withholding tax on profits from NSS with effect from July 1, 2001. However, inflows significantly increased during H2-FY02 due to massive inflows in SSCs in sharp contrast to usual higher investment in DSCs. This change in investor's behavior from long to medium term investment certificates was largely explainable by relatively higher profit rates on SSCs. In fact, during H2-FY02, the government reduced the profit rates on DSCs with effect from January 1, 2002 following the reduction in PIB yield in H1-FY02, while the profit rates on SSCs were kept unchanged. As a result, SSCs became much more attractive as compared to other NSS, which pushed overall gross inflows up during the second half of FY02.

- Gross inflows during FY03 witnessed not only considerable variation during the year, but also remained significantly higher as compared to the previous years. Upto February 2003, inflows seemed normal with the exception of a spike in December 2002. This abrupt rise was the upshot of investors' effort to lock in their funds at higher profit rates before the expected downward revision in profit rates with effect from January 1, 2003. Expectations were realized as profit rates were adjusted downward. However, interest rates on the market-based government securities continued to fall even more sharply during January-March 2003, while rates on NSS remained unchanged as revisions took place bi-annually. This high interest rate differential created an arbitrage possibility in the market (see **Box 5.1**). As a result, investment in NSS saw a steep rise in the subsequent months.

Figure 5.4: Gross Mobilization from NSS*



* excluding prize bonds

Box 5.1: NSS: An Arbitrage Opportunity

Dramatic fall in interest rate on government securities, steep slide in lending rates and unaltered rate of return on National Savings Schemes during H2-FY03 created an interest arbitrage opportunity in the market. Both, investors and banks benefited from this opportunity at the expense of the national exchequer.

Arbitrage opportunity can easily be explained with the help of an example. Suppose that Mr. X has a credit line of Rs 100 from Bank A at markup rate of 8.5 percent. He will use this credit facility to purchase, say, Special Savings Certificates earning profit rates of 8.5 percent. In next step, these SSCs will be used to avail secured lending from the same Bank or another Bank at markup rate of 4 to 5 percent. And, the received funds will be utilized to replenish the credit line availed in first step. In this way, Mr. X will earn the margin of 3.5 to 4.5 percent without taking any risk and doing any real business activity.

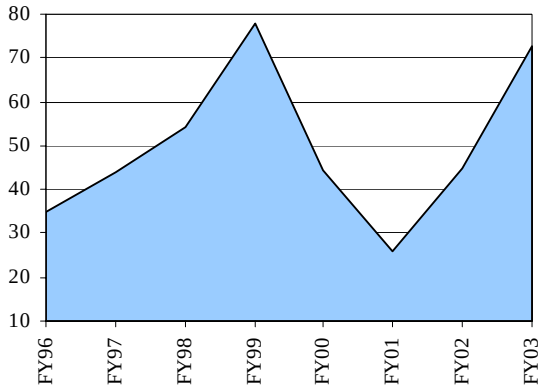
It should be obvious that increasing prevalence of above stated opportunities will divert national resources to unproductive activities. Hence, interest rate distortions also lead to change in mindset of people towards indulgence in unproductive business. This indulgence is not necessarily illegal, though unethical. Therefore, it is best to remove the distortion at source, rather than using an adhoc approach based on imposing procedural hurdles like suspension of sale of NSS from bank outlets.

5.2 NSS, Deficit Financing and National Savings

NSS provide much needed funds to the government for the financing of its budgetary gap.[5] A quick glance at **Figure 5.5** shows the intensity of the government dependence on funds mobilized through NSS that saw a decline in FY01 before picking up the rising trend again in the subsequent years.[6]

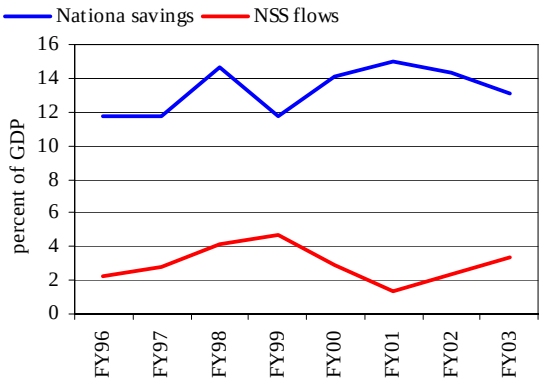
The limited ability of the government borrowing from abroad, and at times ceilings on the government borrowing from the banking system under IMF programs, forced the government to resort to financing of deficit through NSS. In this backdrop, it is quite clear that NSS receipts had played a vital role in bridging the resource gap. However, despite this prime importance, the cost of financing deficit from these receipts can hardly be overlooked, as NSS is the most expensive domestic source of deficit financing.

Figure 5.5: NSS as Percent of Budget Deficit



Another objective of these schemes was to enhance savings in the economy. A quick glance on **Figure 5.6** clearly shows that both inflows in NSS and national savings as percent of GDP do not move in same direction. More specifically, both are approximately moving in opposite directions. This suggests that NSS shift financial savings away from the other financial institutions, largely on account of risk free attractive profit rates. This disintermediation has far reaching implications for financial sector as whole and the banking sector in particular.

Figure 5.6: Trend in Savings vs NSS Flows



5.3 Profit Rates on NSS

The most striking development on profit rates is the linkage of major NSS with PIB: a market-based debt instrument.[7] Following this linkage, profit rates on NSS have witnessed substantial changes over the period of analysis. While linkage of NSS rates helped the government to minimize segmentation in its debt market, relatively smaller decline in bank deposit rates as compared to over 500 basis point reduction in NSS rates helped in squeezing the differential between these rates. Despite this significant reduction in NSS rates, the differential is still considerably high and continues to be a cause of disintermediary pressure in the financial systems, besides undue overburdening of unfunded debt in the economy (see **Table 5.2**).

Although linkage is a step in the right direction, falling interest rate scenario together with the market's ability to adjust almost instantaneously, and pre-announced adjustment schedule have

[5]The annual budget sets targets for gross and net mobilization from NSS. These targets are worked out after taking into account the financing commitments of monetary authorities (Bank Financing) and foreign creditors (External Financing). In simple words, the target is determined as a residual. This overall target for NSS is distributed into specific targets for each scheme and is monitored by CDNS and MOF during the year.

[6]Importance can also be judged from the fact that in the wake of dried-up foreign resources following the nuclear detonation in May 1998, over 75.0 percent of budget deficit during FY99 was financed through NSS.

[7] Profit rates on DSCs are linked with 10-year PIB, RICs with 5-Year PIB and SSCs with 3-Year PIB.

weakened this linkage.[8] This weak link has at times resulted in an interest rate arbitrage opportunity as mentioned earlier. Therefore, efforts must be geared to strengthen the linkage. A look at the real rates of return also provides useful insights. During the five years period (FY98 to FY03), real rates have declined by about 1.8 to 3.5 percentage points (see **Table 5.3**). In fact, these went up in FY02 and are still at a relatively higher level of 6.7 to 7.7 percent compared with real rates on banks deposits which are either negative or close to zero. This comparison suggests that although real returns on NSS are higher, around zero or even negative real profit rates on bank deposits are also a source of concern for the long-term growth of the banking sector.[9]

Table 5.2: Profit Rates on Major NSS and Bank Deposits

Percent

	National Savings Schemes				Bank Deposits			
Profit Rates	**DSCs**	**SSCs**	**RICs**	**SAs**	**Savings**	**1-Year**	**5-Year**	**Overall**
H1-FY00	15.97	14.33	16.00	11.00	6.25	8.45	11.21	5.83
H2-FY00	15.01	12.33	14.00	8.75	5.75	7.76	10.35	5.47
H1-FY01	14.01	11.17	12.48	7.00	5.56	8.24	10.03	5.39
H2-FY01	14.01	11.17	12.48	7.00	5.71	8.19	9.99	5.27
H1-FY02	15.01	12.37	12.48	7.80	4.55	8.26	9.43	4.33
H2-FY02	14.13	12.37	12.48	7.80	3.49	7.19	8.65	3.60
H1-FY03	11.61	10.47	10.56	7.00	3.48	5.89	7.66	3.35
H2-FY03	10.03	8.67	9.12	5.00	1.69	3.10	4.69	1.61
Overall Change	5.94	5.66	6.88	6.00	4.56	5.35	6.52	4.22

5.4 Distortionary Impacts of NSS

As pointed out in above discussion that NSS have strong bearings for the economy in general and the financial sector in particular. The following discussion highlights some of the most important distortions brought about by these schemes.

Table 5.3: Nominal and Real Rate of Returns on Selected NSS

percent

	Nominal			Real		
	DSCs	**RICs**	**SSCs**	**DSCs**	**RICs**	**SSCs**
FY98	18.0	18.0	16.3	10.2	10.2	8.5
FY99	16.0	16.0	15.3	10.2	10.3	9.6
FY00	15.5	15.0	13.3	11.9	11.4	9.7
FY01	14.0	12.5	11.2	9.6	8.1	6.8
FY02	14.6	12.5	12.4	11.0	8.9	8.8
FY03	10.8	9.8	9.8	7.7	6.7	6.7
Decline from FY98	7.2	8.2	6.6	2.5	3.5	1.8

5.4.1 Impact of NSS on Banking Sector

In the presence of almost stagnant national savings, increase in the mobilization through NSS entails the possibility of fund substitutions among competing financial instruments. Here, we consider the substitution possibilities among NSS, fixed deposits and Foreign Currency Deposits. **Figure 5.7** exhibits that net inflows in NSS and fixed deposits generally move in opposite directions, indicating strong substitution possibilities. This implies that increase in net mobilization through NSS is generally accompanied with a decline in fixed deposits of the banking system.

[8] Profit rates on NSS are adjusted with effect from 1st January and 1st July of the year.

[9] Financial health of the banking sector has witnessed considerable improvement over the last two years. Moreover, interest rate spread and intermediation cost both have witnessed marginal improvements. But, a portion of the higher profit was backed by steep slide in interest expense, which led to rise in net interest income in the presence of relatively smaller decline in interest earned by the scheduled banks. Relatively greater decline in interest expense reflects that the banks passed on the negative impact of lower interest rates towards the depositor, with even more intensity, which further depressed the already low real deposit rates.

Furthermore, relationship between net mobilization in NSS and foreign currency deposits also seems to be negative (see **Figure 5.8**), again suggesting the possibilities of substitution.[10] The likelihood of substitution possibilities with fixed deposits and foreign currency deposits can hamper deposit growth in the banking sector.

Figure 5.7: Net inflows: Fixed Deposits vs NSS

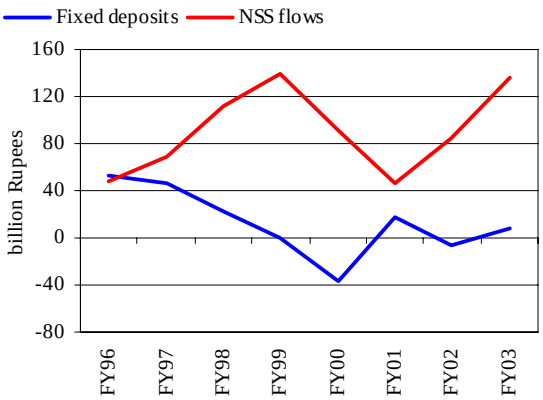
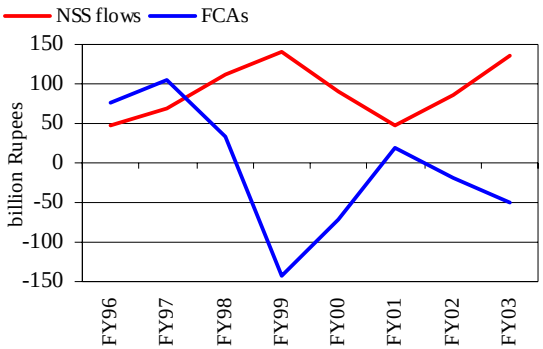


Figure 5.8: Net inflows: FCAs vs NSS



One important implication is that the government borrowing from NSS shifts medium term funds away from the banking sector. As a consequence, the banking sector may end up with a lower fixed deposit base. This may exert an upward pressure on market interest rate that will increase the cost of investment. More importantly, massive withdrawal of deposits in the presence of infected portfolio of the banking system may give birth to solvency problems. Furthermore, a lower fixed deposit base may also limit the banks' ability to engage in new areas like consumer financing. One must keep in mind that the proportion of fixed deposits in total deposits is already considerably lower in Pakistan as compared to a peer group of selected countries.[11]

Since the profit rates, adjusted for inflation, are considerably higher on NSS as compared to bank's fixed deposits, this forces the banks either to keep their fixed deposit rates high to protect their deposit base or switch towards mobilization of demand deposits (see **Table 5.2**).[12] The point is reinforced due to high correlation between NSS rates and bank deposits rates. High real interest rates on fixed deposits and considerable non-performing loans of the banking system may set the floor for lending rates. While, higher lending rates have adverse implications for the economy as a whole.

5.4.2 Impact of NSS on Domestic Debt Management

In budget making process, target for mobilization through NSS is determined as a residual. However, this does not happen in practice, as the government has little control over the inflows and outflows from NSS due to the fact that:

- NSS are issued on tap and carry early encashment facility without any cash penalty.[13]
- In the past, non-interest mechanisms to control flows in NSS seem to be ineffective, at least in the short term.[14] However, these mechanisms may have some relevance for controlling funds in medium term.

[10] According to a recent study by Feltenstein and Iwata (2002), NSS are net substitutes to both bank deposits and foreign currency accounts.
[11] For details see, **Pakistan: Financial Sector Assessment 1990-2000**, SBP 2002, p 125.
[12] Importance of fixed deposits from the banking sector may further increase in future, as the banks aggressively marketing consumer finance.
[13] Only Regular Income Certificates (RICs) attracts cash penalty on early redemption.

Lack of control over inflows in these schemes cerates problems not only for the financing of budget deficit, but for the management of domestic debt also. Wide variation in net mobilization as percent of budget deficit also reflects similar concerns. Higher than expected inflows can lead to unnecessary increase in costly public debt (compared to borrowing from the banking system), while lower mobilization may force the government to resort to short term borrowing from the banking sector (see **Table 5.4**). Therefore, it is extremely difficult to manage inflows as well as the maturity structure of domestic debt.

Table 5.4: Target vs Actual Net NSS inflows for FY03

billion Rupees

Instruments	Target	Actual	Difference
All NSS Instruments	49.6	135.8	86.2
Of which			
DSCs	15.6	22.0	6.4
SSCs	15.0	84.9	69.9
RICs	11.1	-14.9	-26.0
Prize Bonds	10.0	26.8	16.8
Benefit Account	0.0	10.2	10.2

In addition to above cash flow problem, the cost of debt is another major concern. Due to costly borrowing from the NSS, the interest payments witnessed a considerable increase in the past. In absolute terms, interest payments on NSS climbed up from a mere Rs 15.2 billion in FY90 to Rs 85.0 billion in FY03, with an annual average compound rate of 14.2 percent.[15] Overall debt servicing has emerged as the single largest component of the government expenditures. To have a feel of the cost differential, we have estimated the cost of the amount mobilized through major NSS instruments during FY03 at the given profit rate and corresponding PIB rates (see **Table 5.5**).

Table 5.5: Cost Differential of Borrowing from Selected NSS and PIBs during FY03

billion Rupees

		Interest/Profit Rates (%)*		Cost of Borrowing from		
Tenor	Borrowing from NSS	NSS	PIBs	NSS	PIBs	Cost Differential
10-year	34.5	10.8	6.6	3.7	2.3	1.4
5-Year	34.1	9.9	5.8	3.4	2.0	1.4
3-Year	162.6	9.4	4.5	15.2	7.3	7.9
Total	231.2			22.3	11.6	10.7

*: Weighted average of 10, 5 and 3 years PIBs yield is used.

Weighted average of profit rates on DSC, RICs, SSCs are used for 10, 5, and 3 year maturity, respectively.

A quick glance at **Table 5.5** shows that if the government have borrowed the same amount of Rs 231.2 billion from PIBs, it might have saved around Rs 10.7 billion on average per annum.[16] These hefty interest savings might have helped the government to spare some more resources for the development of the infrastructure and other projects of vital importance.[17]

[14] The government has been using non-interest mechanisms to control flows in NSS in the past. These include change in maturity period, discontinuation of old schemes and introduction of new schemes, Zakat and tax treatment, imposition of cash penalty on early encashment etc.

[15] Domestic interest payments jumped up from Rs 34.2 billion in FY90 to Rs 172.0 billion with a compound rate of 13.2 percent per annum. While consolidated revenue receipts and current expenditures registered a compound annual average growth of 12.3 and 12.7 percent respectively. Rise in latter is mainly due to increasing burden of debt servicing, as the growth in defense expenditure was considerably subdued during the 1990s.

[16] Here one can argue that the interest rates on market-based instrument (PIBs) may rise due to this heavy borrowing. But we have calculated the cost on the assumption that if government have not borrowed directly from these schemes, same amount of funds might end up with other financial institutions. In other words, supply of funds would also have increased.

[17] It is generally argued that one specific purpose of these schemes is to help poor fixed income people. This argument does not sound well in the presence of institutional investment in the past and absence of focused groups. Although data on investment in NSS by holder is not available, it is generally observed that instead of low-income people, middle or higher-income groups largely invest in NSS. Therefore, most of the benefits attached with NSS are not availed by the targeted group.

5.4.3 Interest Rate Distortions and Money Market Considerations

A distorted term structure of interest rates has far-reaching significance not only for the financial system but also for the economy as whole. Considerably high profit rates on NSS provided an excellent avenue to earn handsome amount of money without taking any risks. This might have negatively affected the investment sentiments in the economy. As new investment will be limited to only those projects, which can yield higher than NSS risk adjusted real rate of returns.

These high real rates of returns on NSS have also negative implications for the development of capital market, particularly the bond market. In this regard, the following discussion will be interesting.

- ***Corporate Sector***: Real interest rates on NSS have acted as de-facto benchmark for interest rate on papers floated by the corporate sector in the past.[18] The higher benchmark may push the interest rate on medium or long-term corporate papers sufficiently up that this mode of financing may no more be feasible. In other words, the cost of borrowing from bond market may be higher than the borrowing from the banking system. In addition to this, the presence of NSS may limit the market appetite for corporate bonds. These negative implications may not only constrain the growth of corporate sector, but also the development of any long-term bond market. This point seems to be quite relevant as corporate debt market saw a considerable increase in number of new issuance following downward revisions in profit rates on NSS and low interest rate scenario. Moreover, the corporate sector has ultimately shifted to float its debt instruments on floating rates.

- ***Non Bank Financial Institutions***: The above argument also worked against the NBFIs in general and DFIs in particular. In the absence of default risk, interest rates on fixed deposit schemes of NBFIs were slightly higher than the NSS certificates of same maturity.[19] As a result of costly borrowing, the profitability of these institutions was seriously undermined.

Non-availability of maturity profile of NSS due to on tap sale and purchase of these instruments has also an important bearing on the liquidity position in the market. This problem was more severe in the presence of institutional investment that was totally barred from March 2000, before the launch of Pakistan Investment Bonds in December 2000.[20] However, the massive inflows and outflows from these schemes are still undermining efforts to track liquidity in the market.

5.5 Recent Policy Initiatives for Removal of Distortions

Realizing the dis-intermediation impact of higher profit rates on NSS as well as their negative implications for the economy as a whole, the government has undertaken several important steps. Starting point was the cut in NSS rates with effect form May 14, 1999. This was followed by two other cuts in a row effective from January 1, 2000 and July 1, 2000. Meanwhile the government barred all type of institutional investment in NSS during March 2000. Later on, the government introduced a new market based long-term government security, Pakistan Investment Bond (PIB) in December 2000.

Another important step was the linkage of profits rates on medium to long term NSS with a market determined yield on PIB. This task was done with the help of an IMF proposed formula. Profit rates on NSS are adjusted bi-annually, with effect from January 1, and July 1, of each year. Adjustments

[18] Corporate sector usually needs a benchmark in the market to anchor its debt instruments.
[19] "NSS & competing instruments of financial savings: the need for a level playing field", Mushtaq Ali Khan (1999).
[20] Institutional investment in DSCs was already banned with effect from 19th June 1990, however institutions were allowed to investment in other schemes like SSCs. In March 2000, institutional investment was totally banned in NSS.

will take place only, if the post tax returns on NSS differ by more than 0.5 percentage points than the returns on PIB of relevant maturity.[21]

After three successive cuts and linkage of returns, the government imposed a 10 percent withholding tax (with effect from 1st July 2001) on profits from NSS, if the amount in these schemes exceeds Rs 300,000. The government also increased profit rates on these schemes around one-percentage point to equalize post tax returns on NSS and PIB. In the next budget, exemption limit was further slashed to Rs 150,000 only.

Recently, the government has started the sale of DSCs and SSCs against foreign currency in UAE to overseas Pakistanis. The mechanism is quite simple, as the foreign exchange risk will be borne by the investors and the directorate will make all type of profit calculations in Rupee terms.

The government has also launched a new scheme for pensioners and widows that yields 2 percentage points higher profits than RICs. Maximum limit of deposit in this account is Rs 1.0 million only. Moreover, the sale of DSCs and SSCs has been suspended from bank outlets to curb arbitrage possibilities.

5.6 Conclusion

While the recent policy initiatives to streamline the NSS, the alignment of NSS rates to PIB yields and the exclusion of institutional investors from the scope of this scheme are welcome, there are still many distortions which need to be addressed. In this regard, the following suggestions could be helpful;

- The linkage of profit rates on NSS and PIB should be strengthened. For example, if coupon rates on PIB is changed during July, the market yield on these bonds will adjust shortly, while the profit rates on NSS will remain same until end-December. Within this period, NSS may be more attractive. Therefore, it is suggested that the government should monitor the differential between NSS and PIB rates.[22] When this differential crosses the set limits, the rates should be adjusted. Moreover, pre announced schedule of rate adjustment should be abandoned.

- The government should change the characteristics of NSS in such a way that substitution possibilities could be minimized. In this regard, the government can use the limit on size of investment, maturity period, early encashment penalty, tax treatment, eligibility criterion, etc. more effectively. Furthermore, the focus of NSS should be the targeted groups like low income earners, pensioners, widows etc. (who require a monthly income stream).[23]

- Possibility should be explored for replacing DSCs or SSCs with new market-based instruments that are sold either through auctions or subscriptions rather than on tap basis. This can first be initiated on experimental basis. This is also likely to promote discounting activities in the financial sector, as the pre-mature encashment facility will not be available for these new instruments.

Furthermore, there is an urgent need to educate the people to change their mindset. People seem to be quite comfortable with NSS because of relatively higher rates vis-à-vis other alternatives, despite a

[21] Since changes in profit rates entail some cost, therefore the difference of 0.5 percentage points is considered as a cut-off point. Furthermore, change in investment from one instrument to another also carries some cost of shifting funds. It is envisaged that this difference is not much significant to change the investment decisions.

[22] More importantly, efforts must be geared to stabilize interest rates in the market, as these rates have witnessed a great degree of volatility over the past three years.

[23] Recently, the government has introduced two new schemes, (Pensioners' Benefit Account and Bahbood Savings Certificates) which are important steps in right direction, as these instruments have focused targeted groups more precisely.

considerable decline in profit rates in recent years. Other attractions besides profit rate are explicit government guarantee and ease in sale and purchase of these instruments. In this backdrop, while the government is taking the necessary steps, it is also the responsibility of the financial and corporate sectors to come-up with new retail instruments of savings and establish their repute. In this respect, establishment of private pension funds can also help remove the distortions created by NSS.