Why is China's Savings Rate so High?

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China overtook Japan to become the world's second-largest economy after the United States in 2010, but China's economy is quite distinctive in the modern world as it has a comparatively high savings rate and a very low consumption rate. According to the World Bank, in 2010, the gross national savings rate of China is 51 percent, whereas the savings rate of the United States is only 11 percent. Compared with other developing economies or East Asian countries, China's national savings rate is still the highest (see Figure 1).

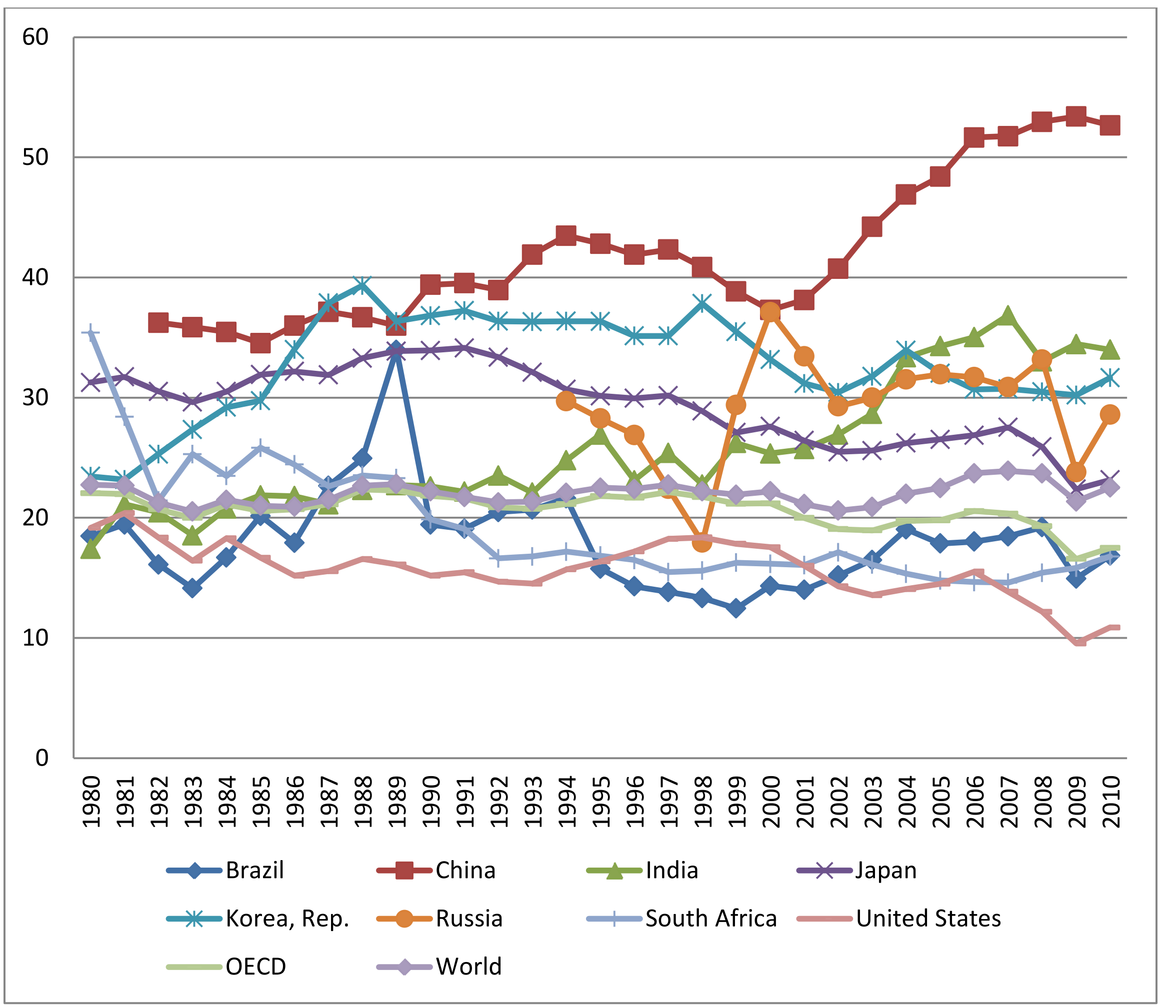

Figure 1

Why is China's savings rate so high? Despite an extensive body of work on this subject, debates continue mainly among economists (Anderson, 2007; Aziz & Cui, 2007; Barnett & Brooks, 2010; Chamon & Prasad, 2008; Guo & N'Diaye, 2010; Hung & Qian, 2010; Kraay, 2000; Loayza, Schmidt-Hebbel, & Servén, 2000; Ma & Yi, 2010; Modigliani & Cao, 2004; Qi & Prime, 2009; Qian, 1988). However, China's situation is "not easy to reconcile with economic theory" (Harbaugh, 2004, p. 1). Theory predicts that consumers with rising incomes should start spending more immediately to enjoy the benefits of future income growth. Clearly this is not the case in China (Harbaugh, 2004; Wen, 2009). Although a lot of factors have been proposed to explain China's high savings rate, such as high growth rate, borrowing constraints, age dependency ratio, low urbanization level, gender imbalance and culture, a significant void in political science and public administration still remains. The only one government factor drew economists' attention is government social spending. The coverage and extent of social safety net do directly affect savings rate (Feldstein, 1980; Hung & Qian, 2010). However, other political and governmental factors also influence savings rate, such as political regime and government regulation.

Political Regime: An Authoritarian State

Research focusing on whether political regimes influence economic growth (savings rate) has produced three schools of thought (Feng, 2003; Samuel P. Huntington, 1987; Sirowy & Inkeles, 1990): (1) the "conflict school," arguing that democracy hampers economic growth, especially in less developed countries; (2) the "compatibility school," claiming that democracy generates the social conditions most conductive to economic development; (3) the "skeptical school," contending that there is "no trade-off" between democracy and economic development (Przeworski, Alvarez, Cheibub, & Limongi, 2000, p. 178).

According to the "conflict school," democracies are generally unable to implement effectively policies considered necessary to facilitate rapid growth. Huntington and Dominguez claimed that "the interest of the voters generally leads parties to give the expansion of personal consumption a higher priority via-a-vis investment than it would receive in a non-democratic system" (1975, p. 60). Economic growth needs capital accumulation. In order to maximize the rate of savings, the larger proportion of national income can be directed toward those who are already well off since they generally have a higher marginal propensity to save. Lacking a political accountability mechanism, authoritarianisms can pursue policies that benefit a minority at the expense of the majority, and thereby advance the accumulation of needed capital (Sirowy & Inkeles, 1990). This school of thought accords well with the experiences of South Korea and Taiwan, which grew rapidly under one-party dictatorships.

As one of the authoritarian countries in the modern world, China's political regime exerts a significant influence on individuals' saving behavior and government's economic policy. Although power in China has become much more dispersed, policy-making is still ultimately under the control of the Chinese Communist Party (CCP). With limited freedom and welfare services, people have to self-insure by saving. Qin (2009) contended that the decidedly high savings ratio is related to the status of human rights in China, particularly workers' rights. Lacking labor rights and independent unions, wages of Chinese workers are far lower than those of other countries' workers. To a certain degree, low wages increase the competitiveness of "Made in China" products. However, it also suppresses individual households' ability to consume since wages are generally the main source of income. Chen (2008) suggested that only democratic institutions can stimulate domestic consumption in China. A key step is to enhance public supervision, especially in the areas of taxing and budgeting.

Government Regulation: A Developmental State

Reagan (1987) defines regulation as "a process of activity in which government requires or proscribes certain activities or behavior on the part of individuals and institutions, mostly private but sometimes public, and does so through a continuing administrative process, generally through specially designated regulatory agencies" (15). Regulation is political. As an activity of government, regulation involves values, interests, conflicts, and the making of choices by persons concerned with constituencies and elections. It can never be "a simple application of microeconomic principles"(Reagan, 1987). Regulation generally puts government and the regulated into an adversarial relationship. And it also involves the intrusion of government officials into matters otherwise within the scope of managerial discretions.

In China, since the CCP is the only one ruling party, the Chinese government plays a key role in the country's economy. As China moved from a command toward a market economy, government commands and central planning have been greatly reduced in scope, but they have not disappeared altogether. National and local bureaucrats continue to exercise a great of control over the production and distribution of resources, goods, and services, and the state still wields the power to make economic policy.

China’s rapid growth in recent years has depended on a development model that has rested heavily on government investment and exports. Generally, Chinese government seems to have followed the same path as the other East Asian states and regions, including Japan, South Korea, and Taiwan. During their periods of most rapid economic growth, all had strong, highly interventionist, and developmentally oriented states—the so-called “developmental state”. Chinese aspects of this developmental state include: a priority of economic development, government support of heavy industry, capital intensive, export-oriented industrialization, the legacy of central planning. In an early stage of development, with an underdeveloped capital market, China’s large pool of savings provided a cheap source of financing through a state-controlled banking system. It is widely recognized that high savings rates are one of the determining factors of China’s economic rise (Aziz & Dunaway, 2007; Harbaugh, 2004). In addition, in order to increase industrial competitiveness, the Chinese government doesn’t require Chinese firms (mostly state owned enterprises) to pay dividends since the enterprise reform started at the end of 20th century. For these enterprises, profits either are reinvested or sit in low-yielding deposit accounts. Therefore, it is no surprise that corporate savings have been rising and become the most important contributor to the recent increase in the aggregate saving (Anderson, 2007; Aziz & Dunaway, 2007; Ma & Yi, 2010). From 1992 to 2004, corporate savings doubled from 12% to 24% of GDP, which approximately equal household savings (Aziz & Dunaway, 2007; Ma & Yi, 2010). In short, China’s investment-led, industry-centered policy and its emphasis on exports have favored corporations and crowded out consumption.

"Understanding saving behavior is not only an important question of economic theory because the division of income in consumption and saving concerns one of the most fundamental household decisions but is also of utmost policy relevance" (Borsch-Supan & Lusardi, 2003, p. 1). China's authoritarian system and powerful government are two important factors of its high savings rate.

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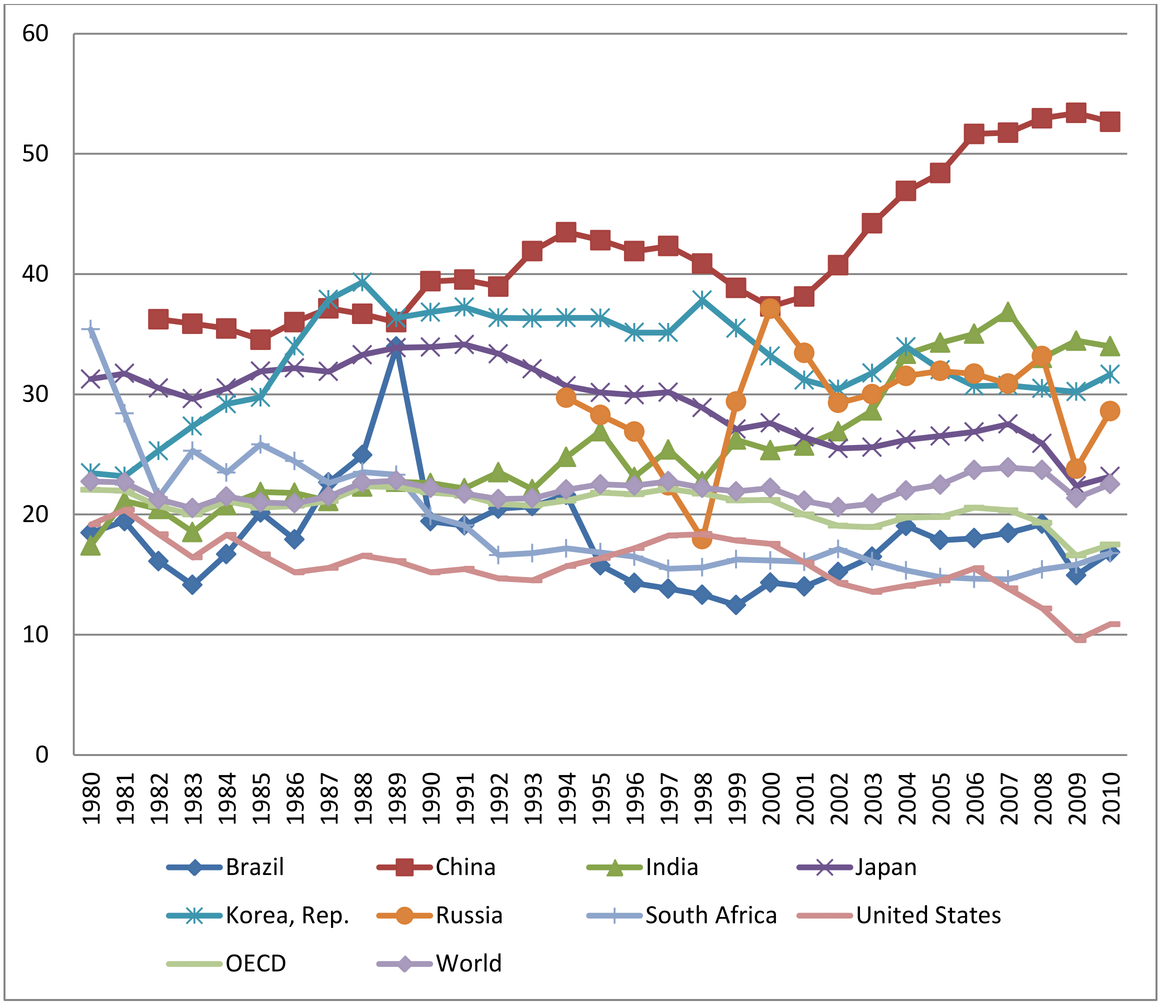

Figure 1. Gross national savings rate. China's national savings rate in recent years.