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China's High Saving Puzzle

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ABSTRACT

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This paper analyzes the causes of rising savings rates for the corporate, government, and household sectors, which have jointly contributed to the upsurge in aggregate savings in China in the past two decades. Government policies to rebalance the Chinese economy are also explored.

JEL Classification: E21, O16, F32

Keywords: aggregate savings, current account, income distribution, WTO accession, trade policies, China

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China's High Saving Puzzle

Over the past two decades, one defining feature of the Chinese economy has been its extraordinarily high and rising saving rate (Ma and Wang, 2010; Yang, Zhang and Zhou, 2012; Yang, 2012). China saves more than half of its GDP, exceeding all OECD economies, overtaking Singapore as the top Asian saver, and ranking the highest among all global economies of meaningful size. China is an outlier in the prediction of aggregate saving from a wide range of empirical models. Moreover, China's saving rate has been exceptionally high relative to its own history. Its gross national saving rate fluctuated at around 35 percent to 40 percent of GDP in 1980–1999, followed by a persistent upsurge reaching 53 percent of GDP in 2010.

Framing the Chinese economy in the context of its saving-investment balance is useful. By definition, aggregate saving plus consumption is equal to GDP; thus, a high and rising saving rate implies a low and falling consumption rate. China's aggregate consumption to GDP ratio declined from 62 percent in 1992 to 47 percent in 2010. However, China's private consumption has been anything but weak. Consumption expenditure grew at some 8 percent annually in real terms during the same period, as testified by the tripling or quadrupling in the penetration of consumer durables, such as color TV, refrigerator, washing machine, air conditioner, and cars.

The declining consumption share is attributable to the fact that the Chinese economy grew even faster than consumption. During the same period, China's annual GDP growth hovered at around 10 per cent per annum, mainly powered by still stronger investment spending. Gross capital formation increased at a breakneck speed of over 12 percent per annum over these two decades, as its share in GDP rose from 38 percent to a staggering 48 per cent by 2010. Remarkably, China's high and rising saving rate—from 36 per cent of GDP in 1992 to 53 percent in 2010—exceeded the country's high level of investment, causing a saving-investment gap. Accordingly, China's current account surplus surged from around 1 percent of GDP to a peak of 10 percent in 2007, before settling back toward 5 percent in 2010. In consequence, within a decade, China swung from a net debtor nation of 10 percent of GDP to a net creditor of 30 percent.

Therefore, such high and rising saving holds the key to understanding China's economic performance and imbalances. Such saving helped finance strong growth, while keeping average inflation at 2 percent in the past decade. China's internal imbalances, a profile of domestic demand driven by "over-investment," have more to do with high saving and little to do with "anemic" consumer spending. The country's external imbalances, large current account surpluses underpinned by an export-led growth model, relate more to high saving rather than under-investment. Thus, any meaningful rebalancing of the Chinese economy begs the puzzling question of why China incurs much saving.

Solving this puzzle has proven difficult. The composition of China's rising gross national saving defies any simplistic interpretations. All three sectors in the Chinese economy—household, corporate, and government—are high savers (see Graph 1). Individually, these sectors in themselves may not be exceptional: as a share of GDP, China's corporate saving at best rivals that of Japan, household saving is below that of India, and government saving is less than that of Korea. However, these combined and simultaneous high saving distinguishes China from its international peers.

The evolving contributions of these three Chinese savers to aggregate saving also challenge conventional wisdom. During much of the 1990s, China's aggregate saving changed little in relation to output, with modest falling household and government saving and corporate saving advancing noticeably to offset. However, from 2000 to 2008, gross national saving rose from 37 percent to 53 percent of GDP. The change in the aggregate saving rate over time can be decomposed into the changes in individual average saving rates and income shares of the sectors. A decomposition analysis for this period reveals three major sources of increased saving: (a) a sharp rise in the share of disposable income of the enterprise in GDP; (b) an increase in household saving rate; and (c) an increase in the government saving rate. All three sectors help drive up the aggregate saving in China.

At least three sets of related questions are important for understanding the high and rising Chinese saving puzzle. First, what are the key driving forces behind the individual saving components and their interactions? Second, what are the prospects for China's gross national saving rate? Third, what government policies are useful for rebalancing the Chinese economy?

A growing body of literature aims to solve this puzzle. Although intense efforts have been allocated to the study of Chinese household saving behavior during the 2000s, it is noteworthy that household saving is only a component of aggregate saving. Chinese urban household surveys suggest a U-shaped age-saving profile in recent years, which sharply contrasts the hump-shaped saving patterns implied by the life-cycle hypothesis. A flattened age-earning profile associated with structural changes in the Chinese labor market, serious gender imbalances leading to greater competition in the marriage market, and reduced pension benefits during economic transition are some of the recent advances toward understanding China's rising household propensity to save. Controversy remains on whether the improving but still limited access to consumer credit and low interest rates help drive personal saving upward. Finally, China's worsening income inequality can lift the household saving propensity.

Corporate saving is the sum of depreciation and retained earnings. Rising corporate earnings were mainly facilitated by enhanced corporate efficiency owing to massive enterprise restructuring in the late 1990s, slow wage growth capped by a large labor pool, and export expansion associated with China's 2001 WTO accession. Controversy remains over the roles of monopoly, subsidies, difficult external financing, and low dividends in boosting retained corporate earnings. However, the central question is not whether these distortions exist, but whether they worsened to become a principal driver behind the increase in corporate profits. With regard to the government, the rise in taxes on production, income taxes, social insurance contributions, and revenues from land sales far exceeded the moderate growth in its consumption. As a result, the government saving rate increased from 3.3 percent of GDP in 2000 to 8.4 percent in 2008.

Some progress has been made in understanding corporate and government saving behaviors. Nevertheless, few attempts have explored the potential economy-wide forces influencing the Chinese aggregate saving in a consistent manner. For instance, rapid growth and industrialization, a sizable pool of surplus labor, and a compressed demographic transition, together with developments in education and housing ownership reforms, may have combined to accentuate a complex transition process that features a falling labor share, boosts corporate profits, and weakens the state company-based social safety net. All these jointly increase the aggregate saving rate. China's WTO entry might accommodate this transition through increased foreign direct investment and expanding overseas export markets, thereby helping explain concurrent rising saving rate and strong consumer spending.

Much remains unexplored and to be learned, but the cumulative research efforts thus far should allow a glimpse at the medium-term prospects of the Chinese saving rate. We judge that this saving rate is probably approaching a plateau and will likely trend lower in the coming decade. If China's pool of surplus labor substantially diminishes in future years, one would expect the increased wage share in the Chinese economy, boosting consumption and dampening corporate profits. Should the anticipated acceleration of China's population aging set in later this decade, the potential output growth may slow and public social spending may rise. Large corporate efficiency gains from painful restructuring may be one-off, and so is the positive income shock emanating from the WTO accession, especially following the global financial crisis.

In general, a gradual easing of China's saving rate from its current high level should eventually imply both a more balanced domestic demand and current account, given its already very high investment rate. However, in reality, rebalancing China's growth model is easier said than done, given the inherent tensions among internal and external rebalancing and growth. History shows that an increase in consumption with decline in saving relative to GDP often relates to measurable growth slowdown. In addition, domestic rebalancing does not necessarily bring about external rebalancing. Indeed, the Japanese experiences in the 1980s show that, during its transition from a mainly investment-driven model toward a more consumption-oriented economy (domestic rebalancing), its current account surplus widened considerably and persistently as the economy slowed.

Three sets of government policy can facilitate the anticipated transition to a lower saving rate. First, a wide range of deregulations could be the most useful measure to manage tensions between growth and rebalancing. These deregulations may include cutting entry barriers to the labor-intensive services sector, improving access to external financing for small firms, and reducing frictions in rural-urban labor migration. These pro-growth measures support jobs and wages, promoting consumption and easing corporate saving. Second, policies may aim to strengthen the social safety net covering healthcare, pension, and low-income supports. An expanded poverty reduction program is also helpful. However, care must be taken to focus on a broader and efficient coverage of basic social services, and avoid unsustainable generous welfare schemes. Third, checks should be put in place to restrain the government tendency to keep to itself a large portion of the growth dividend, without providing sufficient social services accordingly. Tax cuts and administrative fee reductions would be a good start in this regard.

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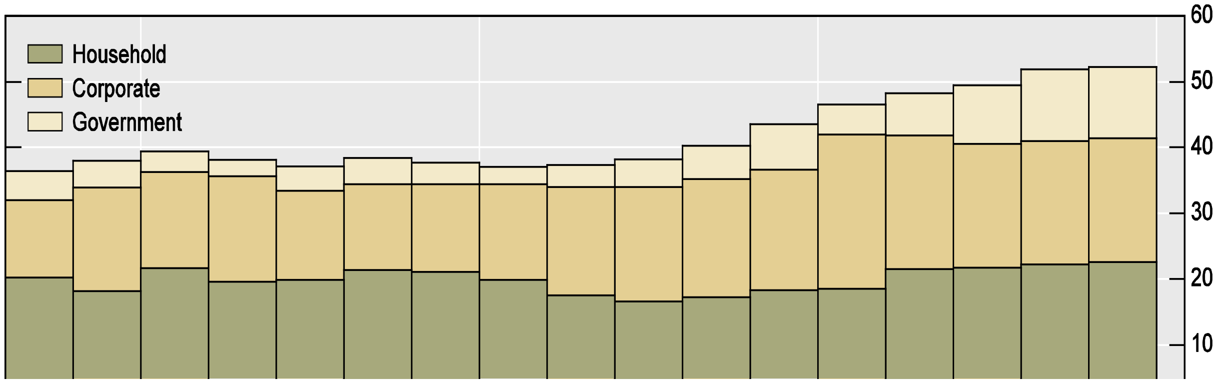
Graph 1. Gross National Saving by Sector

As a percentage of GDP



Sources: ADB; OECD; national data; authors' own estimates.