



ISSN: 1934-4244

China's Future Economic Growth

A Look into High Savings Rates

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Introduction

After many years of rapid economic growth, China is finally seeing signs of slowdown. In the past decade Chinese households have saved a large percentage of their income, however the growing middle class consumers will begin to demand more services. Increased spending will be necessary for China to shift from a low income to a middle-income economy. However, in order for this transition to be successful the government must first set up policies that will create an adequate financial environment.

Household Savings & Consumption in East Asia

Over the past twenty years, countries such as South Korea, and Japan have seen a trend towards increased spending¹. Much like China today, these countries previously faced periods of accelerated growth and high aggregate savings rates (See Table 1). However, in places like Taiwan, savings rates have declined to 26 percent, down from 34 percent². With the help of governmental initiatives China will likely follow this trend.

Table I. High saving/high growth phenomenon

Region	Saving Rate 1992 (%)	Growth Rate GDP p.c (%) 1980–1992
Low-Income	8.9%	2.0%
Middle-Income	20.1%	3.0%
Upper Middle-Income	23.6%	2.9%
High-Income (OECD)	25.0%	3.1%
East Asian Economies	34.0%	4.9%
• China	39.0%	7.6%
• Indonesia	37.0%	4.0%
• Philippines	18.0%	1.0%
• Thailand	35.0%	6.0%
• Malaysia	35.0%	3.2%
• Korea Rep.	36.0%	8.5%
• Singapore	47.0%	5.3%
• Japan	34.0%	3.6%

Source: World Bank WD Report 1991, 1992

Note: Throughout the paper real GDP will be use.

The pattern of low consumption and rapid per capita income growth is common among East Asian economies, particularly in periods of heavy industrialization. During this time economies such as South Korea and Taiwan “provided affordable credit to business by allowing inflation to effectively curtail consumer spending”³. This is a step that the Chinese government has yet to take.

¹ Ma Guonan and Yi Wang, “Why is the Chinese Savings Rate So High?,” *World Economics* 12.1 (2011): 1-26. [Business Source Complete](#). Web 30 April 2012.

² Ibid.

³ Huann H Hung, and Rong Quian, *Why is China's Saving Rate So High?: A Comparative Study of Cross-Country Panel Data* Washington, D.C.: Congressional Budget Office, 2010. *Catalog: Electronic Government Documents (E-Gov)*, Web. 30 Apr. 2012.

Chinese Household Savings & Consumption

During years of accelerated economic growth, Chinese consumers have accumulated over \$1 trillion in savings⁴. The aggregate savings rate reached 23 percent in 2003, an incredible number when compared to the historically low level of American household saving rate of 2 percent⁵. By 2007 the national saving rate in China was 54.4 percent of gross national income.⁶

On average Chinese households keep 86 percent of assets in cash and low yielding bank deposits, however the overall capital markets give low returns on savings. Koreans normally earn 1.8% return, a large sum as compared to the 0.8% in China.⁷ Additionally, financial intermediaries are scarce creating a lack of investment opportunities. Finally, from 2003 to 2007 China's current account surplus rose from 2.8 percent to 10.1 percent. In 2008 China's surplus was \$412 billion, which was 9.1 percent of GDP. In theory, countries with a current account surplus enjoy higher return on savings, whereas countries with current account deficits benefit from lower investment costs.⁸ However, this is not the case in China. Further, the lack of financial alternatives leads to lower consumption and higher levels of savings.

Additionally, "rising housing prices have been perceived as one of the most important factors underlying China's high aggregate household saving rate"⁹. It is estimated that a young married couple would have to save their entire income for twelve years in order to afford a 600-square foot apartment. Due to the borrowing constraints in China, households need to save large sums of money before they can think of purchasing their own homes. It is also important to note that rural households also tend to save in large quantities. This is due to their dependence on agricultural income.¹⁰ Rural households are therefore subject to a more volatile source of income, and will save more as a precautionary method.

The uneven distribution of wealth and income also contribute to high savings rates. Other factors include rapid income growth, aging population, cultural tradition, high costs of education and healthcare, and lack of social safety nets and unemployment insurance¹¹.

The Impact of Savings

The lower consumption rate in China has created an overdependence on exports. The domestic market cannot sustain the large number of Chinese products, so they become "confined to the oversea markets."¹² Furthermore, China depends on external markets to absorb its own overcapacity. The underdeveloped state of the Chinese banking system resulted in large

⁴ Gordon R. Orr. "Encouraging Consumer Spending in China". *McKinsey Quarterly*

⁵ Xin Wang and Yi Wen. "Can Rising Housing Prices Explain China's High Household Saving Rate?."

⁶ Chen Shi, "Analysis On China's Low Household Consumption." *Canadian Social Science* 7.2 (2011): 72-79. *Academic Search Complete*. Web 25 April 2012.

⁷ Diana Farrell, Susan Lund, Jason Rosenfeld, Fabrice Morin, Niyati Gupta, and Ezra Greenberg. "Putting China's capital to work: The real value of financial system reform". *McKinsey Global Institute*

⁸ "China beset by internal imbalance," *The Irish Times*, April 12, 2004.

⁹ Xin Wang.

¹⁰ Huann H Hung.

¹¹ Xin Wang and Yi Wen, "Can Rising Housing Prices Explain China's High Household Saving Rate?." *Federal Reserve Bank of St. Louis Review* 93.2 (2011): 67-87. *EconLit*. Web. 30 Apr. 2012.

¹²Chen Shi.

currency reserves that were then recycled in American and European debt markets, resulting in lower interest rates overall¹³. However, soon China will not be able to finance foreign debt.

Having expanded through exports, there is now an growing middle class. Furthermore, there will be an increase in demand for services and growth in the service sector. Hopefully, as wages and income also continue to rise, Chinese consumers will increase spending, providing a market for European and U.S. exports.¹⁴ In order for this transition to be effective, the Chinese government will have to allow its currency to appreciate, in order for imports to be affordable.

Promoting Greater Spending in China

Although the Chinese government has taken measures to stimulate short-term consumer spending in the past "through the consolidation of national holidays into week-long breaks"¹⁵ these efforts are not enough. With a presidential transition coming up in the next year, Chinese government officials have already begun planning for an overall shift to consumption led growth. At the completion of the 2011 National People's Congress, a five year plan was set forth for the country and its future leaders. This five-year plan serves as a means for policy continuity during leadership transitions.

Among the goals outlined for the new administration in 2012 are increased social welfare measures and increase in minimum wage. Moreover, future policies will attempt to loosen the state's grip on the banking system, in order to serve small and medium sized enterprises.¹⁶ Further, as the Chinese population continues to become more affluent, their demands also become more apparent; quality of life is becoming increasingly important.¹⁷ China's new leadership will be handed a country with a rapidly growing middle class, and the transition from a middle-income country to a high-income country will be difficult.¹⁸ A shift towards a new development model that emphasized technological innovation and consumption growth will be crucial.

Conclusion

As China's economy shifts towards a service-based economy, growth will slow down. Chinese policy makers need to be prepared to open up their country's economy and allow currency to change with market trends. Government reform should steer China away from lending to foreign countries, and instead give domestic loans either for personal use of citizens to purchase homes,

¹³ "Paradox of Thrift; Global recovery may be helped rather than hindered by slower Chinese growth," The Times, 6 March 2012, LexisNexis Academic, 20 April 2012. <<http://www.lexisnexis.com/hottopics/lnacademic/>>

¹⁴ *ibid*

¹⁵ Ma Guonan.

¹⁶ "China: Phase 2; Giant at crossroads in drive to generate 'middle-income growth,'" National Post's Financial Post & FP Investing, 7 April 2012, Ed: National, LexisNexis Academic <<http://www.lexisnexis.com/hottopics/lnacademic/>>

¹⁷ Ma Guonan.

¹⁸ Melanie Hart, "China's Forthcoming Political Transition". Center for American Progress 9 February 2012: 1-9. 20 Apr 2012. <http://www.americanprogress.org/issues/2012/02/pdf/china_leadership.pdf>

or to start their own small or medium sized businesses. China will continue to be a major player in the global economy, much like its East Asian counterparts, however policy makers need to be prepared for the implications of this shift.

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