

Obsession with saving remains an obstacle for investors in retail sector

# Thrift culture still rules on the mainland

**Jacob Leibenluft**

Despite all the supposed virtues of frugality, few people have many nice things to say about the mainland's enthusiasm for saving.

For the central government, the country's overall savings rate – which now stands at about 50 per cent of its gross domestic product – has inhibited the mainland's evolution into a more mature, consumption-based economy. For the retail sector and its growing cast of investors, that thrift presents a major obstacle to unlocking the potential buying power of mainland consumers. For Beijing's main trading partners, a decline in savings would provide an easy fix to its huge current account surplus.

Yet even as the calls for a spend-thrift mainland have grown louder, the nation's savings deposits have topped 16 trillion yuan while consumption has dropped as a percentage of the overall economy. Three recent papers by some of the top experts on the mainland's economy suggest a significant fall in the savings rate is unlikely anytime soon.

"The high savings rate is not a temporary problem," says Sun Lijian, an economics professor at Fudan University. "It is a structural problem."

In a historical sense, the mainland's penchant for savings is a relatively new phenomenon. Until economic reforms began in 1978, household savings stood at only about 5 per cent of disposable income; by the mid-1990s, that figure had climbed to 30 per cent, and was widely credited for helping fuel the country's rapid growth. Household savings have since dipped slightly, to about 25 per cent, but still remain significantly higher than those of virtually any other country in the world.

That the mainland has a high savings rate is in itself unremarkable. When countries experience rapid

economic growth, their savings rates tend to go up because it takes time for spending to catch up with income.

Likewise, the same economic restructuring that set the stage for the mainland's boom added an element of financial uncertainty for individuals. As state-owned companies grew leaner – cutting jobs and trimming the social safety net – families increased their "precautionary" savings to prepare for the possible costs of unemployment, sickness or retirement. But one paper suggests that even taking account of the mainland's economic transformation over the past three decades, its savings rate is still exceptional. Using a range of cross-country variables, World Bank economist Louis Kuijs estimated in a 2006 paper that the main-

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land's savings rate was about 12 per cent higher than its basic economic conditions would predict.

Dr Kuijs says families explain only some of the discrepancy. Even as household savings rates have steadied as a percentage of GDP, Dr Kuijs notes, business and government savings have skyrocketed.

The mainland's reliance on industry is one explanation: industrial enterprises invest more than companies in the service sector or agriculture, so their savings rates tend to be higher, Dr Kuijs says. Since mainland enterprises seldom pay dividends, high profits in recent years have been ploughed back into the companies, further boosting corporate savings.

The central government has also shown a tendency to boost savings by keeping spending relatively low and transferring significant sums of money to state-owned enterprises.

Until recently, however, conventional wisdom suggested that it might only be a matter of time before the mainland's savings rate – both at a national and household level – moved into line with that of other countries. Sustained economic growth would eventually give households the confidence to spend without worrying about financial disaster. As the mainland aged, the savings rate would inevitably drop, as the ageing population drew down on their nest eggs to pay for health care and retirement.

But Eswar Prasad, a former China division chief at the International Monetary Fund who now teaches at Cornell, says recent history suggests a more complicated picture.

Standard economic models for how individuals spend and save over the course of their lives – the so-called "life-cycle hypothesis" – contend that spending patterns follow an "inverted-U" shape. When workers are young, they spend a lot relative to what they earn, often borrowing against future income through mortgages and other loans. As they get older, they start saving in preparation for retirement. Finally, as they leave the workforce, they start spending much more of their income.

On the mainland, data on household behaviour shows a different story, Dr Prasad says. Without easy access to credit, youngsters save at high rates. Older workers are particularly frugal as they prepare for retirement, but even some retirees are still saving, Dr Prasad finds in research with IMF economist Marcos Chamon.

Eventually, Dr Prasad says, the mainland's demographics may push savings down. But middle-aged workers – born just before the one-child policy was enacted – are both so numerous and so inclined to save that a shift is unlikely to come anytime soon.

"Just in terms of sheer numbers, they could keep the savings rate higher for the next decade or decade and a half," he says.

In another paper, [Charles Yuji Horioka](#) and Junmin Wan, two economists at the Osaka University, challenge the idea that demographics play a large role in determining savings. Yet they come to a similar conclusion: the mainland will keep saving, largely because households don't change behaviour quickly.

"Even if China's household saving rate declines, it won't decline all that rapidly," Dr Horioka says. "Most people are expecting income growth to remain high, and moreover, there's a strong persistence effect preventing the saving rate from changing too dramatically."

For those counting on a consumption boom, all three papers still provide some reason for hope, noting policy changes could lay the groundwork for an eventual savings decline.

The first step, they all agree, is a strengthening of the social welfare system – a move that would both lower government savings and encourage consumers to spend more.

The experts also point to a wide range of necessary financial reforms that would reduce both enterprise and household savings, from encouraging companies to pay dividends to increasing access to loans.

Dr Kuijs estimates that these reforms – combined with growth in the services sector – could lower the mainland's savings rate by as much as 18 per cent over time.

However, Dr Kuijs points out that those policies would lower investment, too – meaning the impact on the current account surplus would be smaller. And even if Beijing is committed to those policies, Dr Kuijs concedes that the changes in the savings rate would only occur over a long period of time.

## Super savers

Comparable rates of savings (% of GDP)

	China	US	Japan	S Korea	India
<b>Total domestic</b>	41.7	14.3	25.5	31.0	28.3
<b>Household</b>	16.0	4.8	8.2	4.5	22.0
<b>Business</b>	20.0	10.3	19.4	14.8	4.8
<b>Government</b>	5.7	-0.9	0.3	-2.2	1.5

Data for China is for 2005, for India 2004 and for other countries 2002

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SOURCE: KUIJS (2006)



Shanghai's middle class may be embracing consumption, but mainlanders overall are savers not spenders. Photo: Bloomberg