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Why Do Chinese Households Save So Much?

China is a poor but rapidly developing country; its per capita, nominal income is about $1,700 (about 1/25 of that of the United States in 2005). Nevertheless, as a fast-growing country with an average growth rate of 9.8 percent a year over the past 25 years, China's income prospects are bright. Total GDP is predicted to equal that of the United States by 2032.[1] Given such rapid growth, economic intuition would indicate that China has little need to save and instead has a strong incentive to consume today because the fundamental purpose of saving is to enable future consumption. In other words, Chinese households may improve their welfare by consuming more now because they can reasonably expect to be much richer in the future. Despite this fact, China's saving rate is one of the highest in the world. The figure shows that China's personal saving rate is about 25 percent and national saving is roughly 47 percent of GDP (in 2005, compared with 0.5 percent personal saving and 12 percent national saving in the United States)—and these savings rates have increased in recent years.

Why do Chinese households save today to consume even more in the future? Several factors may contribute to this behavior. First, the economic reform in China that started in 1978 increased income uncertainty because many jobs were no longer government-paid: People save more because they are more uncertain about their future.

Second, since 1978 the Chinese government has gradually shifted the burden of retirement income to households. Hence, increased savings are needed for retirement, which formerly was essentially free. This change further increased the already high personal saving rate.

Third, China's financial market and banking system is still underdeveloped and only recently began to reform. As a result, borrowing for housing, education, medical care, and other big expenses is very difficult. Even today, mortgages require at least a 30 percent down payment, assuming a loan can be obtained. In addition, real estate prices are very high compared with incomes. In Beijing and Shanghai, for example, the median price of a 1,000-square-foot apartment is about $100,000 at current exchange rates. If the average annual income per capita in Beijing and Shanghai is about $2,000, then the average Chinese worker needs to save his or her entire annual income (a 100 percent saving rate) for about 50 years to buy an apartment. Even if a borrower can obtain a mortgage, the 30 percent down payment means a one-time payment of $30,000—equivalent to about 15 years' income (ignoring interest payments). Such high real estate costs have boosted the savings rate.

Economic theory predicts that the development of financial market and social insurance programs may dramatically reduce China's saving rate (at both household and national levels). Such a decline in the saving rate may slow China's speed of growth because economic growth is driven partially by domestic investment, which in turn is financed mostly by domestic saving.

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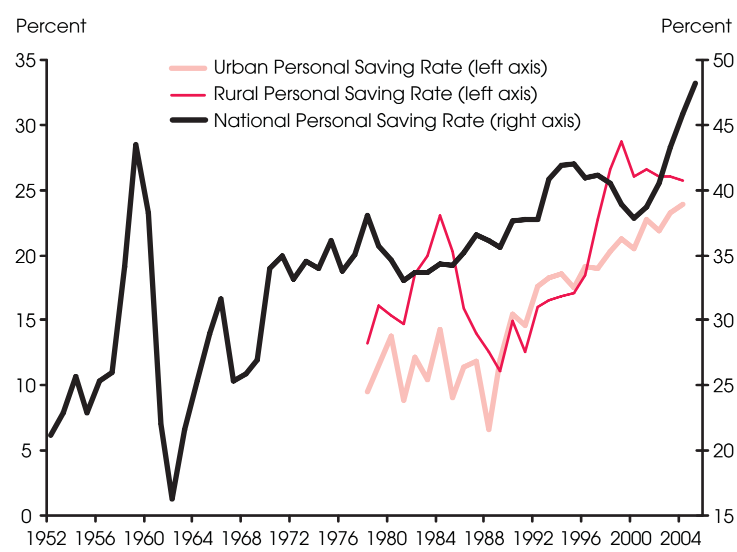
[1] The computation assumes that the United States grows at the average postwar rate.



SOURCE: *China Statistical Yearbook–2006* and authors' calculations.