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Zhou, Shaojie. 2007. "Essays on Household Consumption and Household Saving Behavior of Chinese Urban Residents." PhD diss. The Chinese University of Hong Kong.

Comment Leslie Young

Introduction

Professors Yang, Zhang, and Zhou (YZZ) provide useful insights into the question in the title of their chapter. As their work covers a lot of interesting ground in a highly professional manner, I shall not offer a detailed critique. Instead, I shall propose some alternative perspectives on their work that link China's savings rate to fundamental aspects of its modern history and political economy. Specifically, I link China's high savings rate to (a) the social capture of the rents and capital gains foregone by the landlords and capitalists expropriated after 1949, and (b) the recycling of those surpluses into investment by both private companies and state-linked companies. The capital gains on the expropriated assets were massive when China opened up its economy and revalued those assets at world prices. The recycling of the surpluses into investment was massive because China's state-linked corporations effectively have no owners, but their managers now earn both monetary and political credits from good performance. We might say that China's savings are high because of Mao Zedong, Deng Xiaoping, and the "social market economy with Chinese characteristics."

Evidence from the Relative Purchasing Power of National Currencies

A useful perspective on the "revolutionary" origins of China's high savings is provided by the well-known impact of revaluing China's GDP according to Purchasing Power Parity. China's currency stands out from competing countries in enjoying high purchasing power relative to the US$. According to 2007 World Bank figures, 1 yuan buys in China 2.21 times what its US$ equivalent at market exchange rates would buy in the United States. For Brazil, Mexico, and Poland, the corresponding factor is about 1.43.

So Chinese firms could pay 1.43/2.21 = 0.65 of the salaries in these three countries, yet their workers would enjoy the same purchasing power. The Chinese firms competing with firms from these three countries could capture the difference as higher profits. Yang, Zhang, and Zhou show that profits are mostly saved, rather than being paid out as dividends.

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Or the Chinese firms could pay more—say, 0.85 of the salaries in the other countries. Then the Chinese workers could consume as much as workers in the other countries, yet save more of their income. Meanwhile, the Chinese firms would face a wage bill equal to only 0.85 of their foreign counterparts, allowing higher profits and savings. If the Chinese firms were competing with US firms, then more savings would be possible.

If a Chinese firm A were producing inputs for another Chinese firm B that exports, then A could charge less than international prices (at market exchange rates). A's profits would be lower than discussed before, but B's profits would be higher. If A were producing goods that were consumed in China, then it could charge less than international prices (at market exchange rates). Then its profits would be lower than discussed earlier, but the cost of living would be lower also.

So, whatever prices of B-to-B and B-to-C transactions in China, Chinese firms and workers would jointly enjoy the additional opportunities to save as just discussed.

Chinese Interest Rates and Dividends

State-related firms can access low-cost loans from state banks; their loans are often forgiven. The resulting advantage over international counterparts shows up as higher profits and/or higher disposable income of the workers. Giovanni Ferri and Li-Gang Liu[1] argue that almost all the profits of state-related enterprises can be explained by favors from state banks.

How could Chinese banks afford to charge low interest rates and forgive loans to state enterprises? They pay low deposit rates. In the past, they were recapitalized by the Chinese state from taxation and seignorage. As China's market economy had grown fast and its immature financial system ensured a low velocity of circulation, it could print a lot of money without triggering inflation.

Yang, Zhang, and Zhou report that Chinese firms pay essentially no dividends. Unlike firms abroad that do pay dividends, they can save and reinvest all the dividends and/or charge lower prices and/or pay higher wages. Whatever the prices of B-to-B and B-to-C transactions in China, Chinese firms and workers as a whole would enjoy additional opportunities to save.

Chinese Rents

The state owns all land, but allows local governments to allocate or sell the use rights and retain the proceeds. The local governments can:

- Charge market rents, and use the proceeds to deliver government services. Then for given government services, China can tax less. This increases the disposable income of workers and firms, which they can

1. Ferri and Liu, "Honor Thy Creditors Before Thy Shareholders: Are the Profits of Chinese State-Owned Enterprises Real?" Hong Kong Monetary Authority Paper no. 16/2009.

save. In 2006, sales of land use rights accounted for 35 percent of the revenue of local governments.

- Charge below-market rents to firms (e.g., to attract them to start up locally and pay local business taxes). This increases the profits of firms, which they can save.
- Charge below-market rents to workers. This increases their disposable income, which they can save.
- Use the proceeds from the sale of land use rights to fund new investments. The local government would own these new firms. It typically collects business taxes but refrains from collecting dividends.

Whatever the prices of B-to-B, B-to-C, and B-to-G transactions in China, Chinese local governments, firms, and workers would jointly enjoy additional opportunities to save.

The firms set up by local governments either from land sales or from their legacy of state assets or from reinvested profits need not pay dividends. As previously discussed, this would show up as additional opportunities to save, either by firms or by workers.

Many Chinese farmers pay below-market rents for their land so they can enjoy decent living standards, despite receiving lower prices for their output than their international counterparts. Many Chinese workers enjoy low rents from state housing, low prices of food grown on low-rent state land, and low prices from Chinese firms that can pay low wages and rents so they can enjoy decent living standards, despite receiving lower wages than their international counterparts. And the firms employing them can charge low prices and still earn good profits. In fact, these two points explain the relatively high purchasing power of China's currency that was noted before: costs in rival economies are hiked up by market-driven rents.

The land on the edge of China's cities is being converted to urban use only after substantial economic growth has taken place, so local governments capture the capital gains and use them to fund new firms; that is, these firms are funded from the growth process itself and thereafter added to corporate savings, since they do not pay dividends to the local governments. This contrasts with other countries where land is privately owned: the landlords capture the capital gains. Insofar as they invest these capital gains in firms, they would expect dividends thenceforth.

Behind China's High Savings: Mao and Deng

The previous discussion traces China's high savings to the state assets that were:

- "Liberated" from landlords and capitalists after 1949.
- Built up in the central planning era, when central planners set wages low so that state enterprises enjoyed high profits that could be reinvested to build up state assets.

- Created/maintained through loans from state banks during the transition from central planning (which were often paid off from seignorage).
- Funded from the capital gains on state land as China urbanized.
- Funded by the reinvested profits of state firms.

So we can interpret China high savings as:

- The foregone income and consumption of the landlords and capitalists whose assets were "liberated" after 1949, enhanced by subsequent capital gains and income from the assets that China built up from their contributions—in effect, the foregone consumption of their heirs.
- The foregone income and consumption of workers during the central planning era—enhanced by subsequent capital gains and income from the assets that China built up from their contributions. In effect, the foregone consumption of the capitalists who have been prevented from owning and operating the firms after 1949.
- The social capture of the surplus from the improved division of labor as China's economy developed and grew, as manifested in seignorage, capital gains on state land through urbanization, and the profits of state firms.

Deng's reforms allowed private enterprise, but the state kept its assets or reinvested the proceeds from their sale to create other state assets. State assets had funded social services—health, education, and pensions. Citizens who exited the state economy lost their entitlement to these social services, so they had to save to pay for the services themselves. But the state assets continued to grow in value as the reforms deepened. The citizens of China were the notional owners, but lacked explicit claims. So they saved twice over: as individuals and via the state.

Conclusions: The Political Economy of Savings

China's high national savings are rooted in its institutional structure: the Chinese state has assets growing under the management of state-linked firms but these are not offset by explicit liabilities to its citizens. By contrast, the institutional structure of the United States means that the state has heavy explicit liabilities to its citizens (e.g., their entitlements to Social Security and Medicare) but lacks assets to support those liabilities.

Underlying these contrasting institutional structures are contrasting political economies and political ideals. The Chinese state is owned by the Communist Party, but retaining ownership requires retaining legitimacy. Growing the economy at a high rate confers legitimacy; growing a large proportion of assets under party control provides rewards to the party elite, while keeping taxation low. The US state is legitimized by democratic votes—of the current generation. So democratic politicians tend to shift liabilities to future generations. The current generation trusts the rule of law, specifically, the state's legally-binding promises to fund pensions and health care when it retires. Hence, it feels less pressure to save.

In sum, China saves at a high rate because it is a "social market economy with Chinese characteristics," just as the United States saves at a low rate because it is a democracy under the rule of law.