

# An Analytical Framework of Cultural Influence on China's Household Saving

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*This paper reviews the historical household saving trend of selected economies at the take-off stage, and identifies the emerging themes of the cultural aspect of household saving. It develops a framework to research the cultural influence on China's household saving. The framework centers on Keynesian saving theory incorporating Institutional Economics concepts and Lu Xiyue's Chinese cultural system. The paper argues for an appreciation of the cultural influence and discusses its implication for China's sustainable development.*

**Field of research:** Economics, development economics

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## 1. Introduction

The landscape of China's household saving is set in the context of China's rapid economic growth (measured as an increase in GDP) since 1992 following the economic reform. There are varied reasons for Chinese households to save. The most common explanations include: saving for retirement, healthcare, housing, children's education, etc. (Beijing Review, 2009). Research studies find stages of development (Zhou, 2009), life cycle (Modigliani and Cao, 2004), social-safety net, financial underdevelopment (Aziz and Cui, 2007) and demographics contribute to China's high household saving rate.

The 2007-2009 global economic downturn, set off by the Global Financial Crisis, highlighted the issue of savings in the economic landscape. The household saving rates between developed and emerging economies are divergent. The surging household indebtedness and declining savings in many developed economies (Battellino, 2010) result in low level of household saving rates; while the household saving rates in emerging economies such as China, are high (Blanchard and Giavazzi, 2006). Why is there such divergence?

The studies on culture and household saving are limited and lack of consensus. Carroll, Rhee and Rhee's (1994) study of migrants' saving in Canada finds no evidence that cultural factors influence household saving. Modigliani and Cao's (2004) study dismisses that culture influences China's household saving. Mr. Li Peilin (Beijing Review, 2009) attributes China's high household saving rates to cultural factors of habit, non-use of consumer credit and saving for children's education. Chinese Central Bank governor Zhou Xiaochuan (2009) compares economies of similar stages of development and asserts culture as the influence on China's household saving. Zhou finds that Japan's household saving rate is higher than the United State of America's (USA) of the developed economies. Zhou (2009) attributes the Chinese high household saving rate to the value of thrift, self-discipline, and the Confucian 'Zhong Yong' – the Golden Mean of balance. However, the cultural influence on China's household saving is 'not theoretically well grounded' (Jha et al., 2009).

United Nation (1987) defines sustainable development as 'development that meets the needs of the present without compromising the ability of future generations to meet their own needs'. Drawing on contributions within development economics from both Western and Chinese intellectual traditions, this paper argues for an inclusion of the cultural dimension in economic analysis of saving.

Organization of the paper is as follows: First, the definition of saving, culture and China's cultural system are introduced. Second, the historical saving trend in selected economies is presented to identify the significance of culture and its role in China's household saving. Third, significant theories on household saving are reviewed. Fourth, the analytical framework is presented. Finally, a conclusion highlights the implication of this framework for culture's role in China's future sustainable development.

## 2. Literature review

Culture is complex. There are various definitions of culture in different disciplines. Culture is defined as 'the way of life' and 'the learnt behavior' (Geertz, 1973) in anthropology. Throsby (2001) broadly defines culture as 'attitudes, beliefs, mores, customs, values and practices which are common to or shared by any group'. Culture is referred to as 'the mental program' (Hofstede, 1994) of the shared beliefs and values.

North (2005) recognizes that culture is bound by institution that sets 'the rules of the game' which we all must abide by to be able to live in a human society. Culture has many layers, according to Trompenaars and Hampden-Turner (1997), the outer layer is represented by explicit symbols, such as language. The middle layer is where the norms and values are; the core or deeper layer is where the implicit basic assumptions about existence are embedded.

Culture in the current study, using concepts of institutional economics, refers to the commonly and widely recognized rules of the game, culture refers to the *tradition, norms, value* orientation and *deep-rooted habit* (Hodgson, 1988, North, 2005).

Saving and consumption are two interdependent components of current disposable income. Keynes defines saving as 'the excess of income over expenditure on consumption' ([1936], 1973). Consumption is for current needs and satisfaction, saving is the build-up of wealth for future needs and satisfaction. Both the action of saving and the level of savings will be referred to in the paper. Bank deposits (Aziz and Cui, 2007) are the main form of savings for Chinese households.

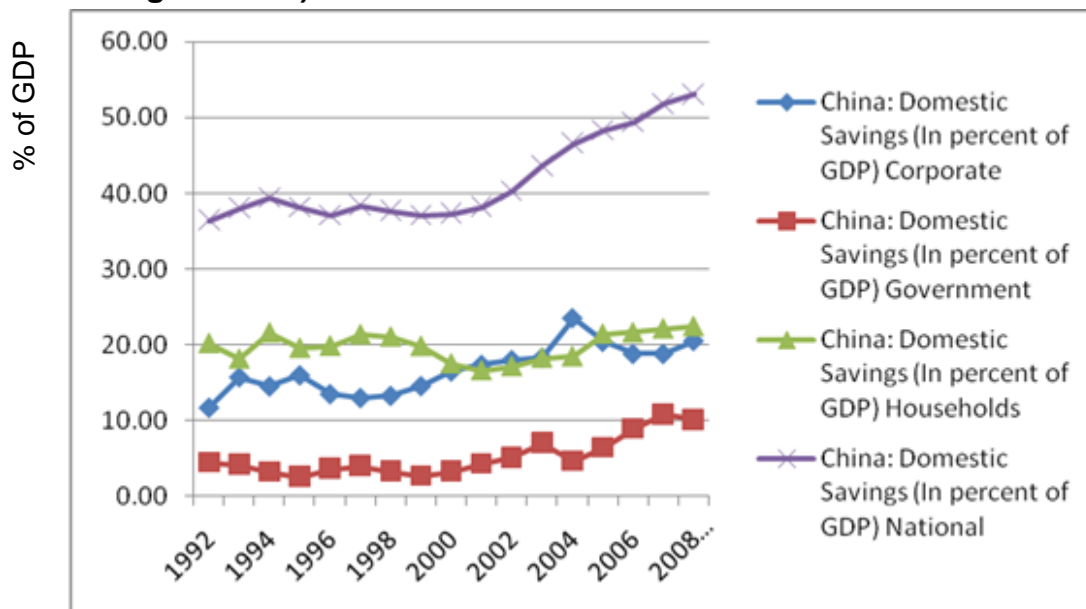
China's cultural system is described as a pyramid consisting of interdependent aspects: the foundation of traditional culture, with mainstream culture, elite culture, mass culture, regional culture, and influence of foreign culture (Lu, 2009). The foundation of traditional culture is based on the values and social norms rooted in the Confucian tradition, it is a fusion of Buddhism introduced from India, Confucianism and Daoism (Kong, 2009). This foundation of China's cultural system is at the base of the pyramid. On top of this base are the five interdependent aspects of the Chinese cultural system, all influencing the traditional culture. In this paper, the focus is on the culture of the country, but not its regional subcultures.

National savings in an economy comprises of three sources: households, corporate and government. What can be observed from Figure 1 is the strong constant role played by household savings. This is the aspect to national savings that is examined in this paper.

Household saving rate is measured as the proportion of GDP (Jha et al., 2009) that is saved by households out of disposable income plus saved by private unincorporated enterprises out of unincorporated surplus. A different perspective on household saving is the measurement of household saving as a percentage of disposable income of households (Jha et al., 2009) together with surpluses of private unincorporated enterprises. Figure 1 shows all three saving

rates in China to be positive with household saving rates ranging from around 15 to 20 per cent. This trend continues into 2009 (Chamon et al., 2010).

**Figure 1. Composition of China's saving rates 1992 – 2008 (as a percentage of GDP)**



Sources: International Monetary Funds, *Data*, available: <http://www.imf.org>.

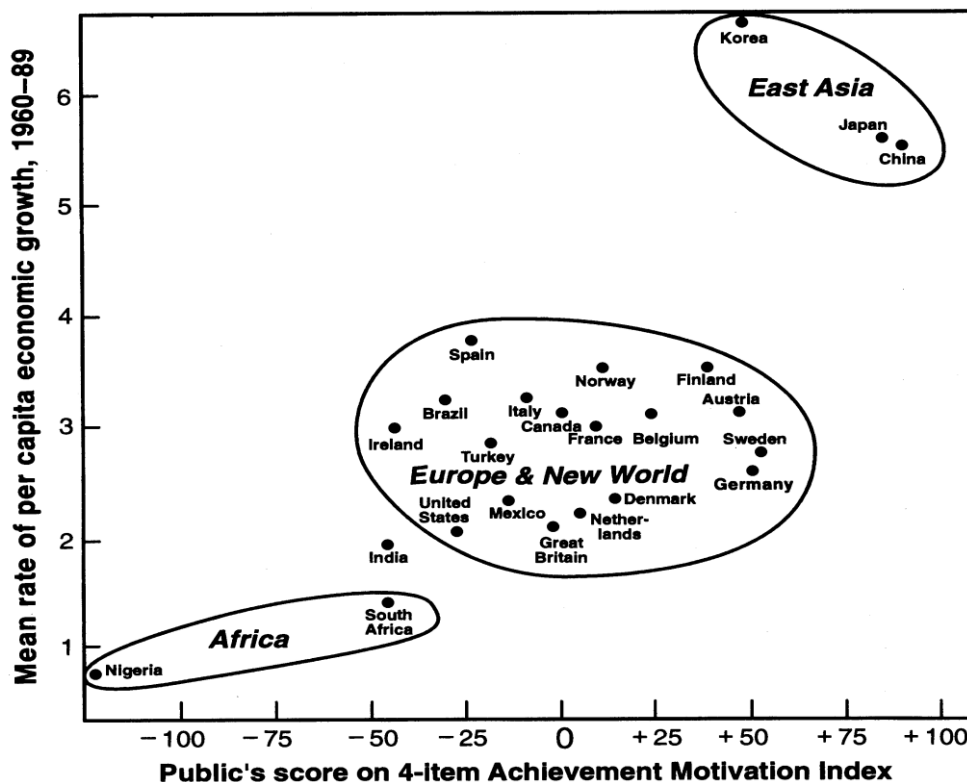
A review of the historical trend of selected economies indicates that household saving rate tends to be high in take-off stage. As the economy moves to the higher stage of maturity and mass consumption, household saving declines. The household saving rate of USA was averaging 8 to 9 per cent in 1950s to 1960s (Abdih and Tanner, 2009), that of Japan was averaging 19 per cent in 1960s to 1970s (Hayashi, 1992) and South Korea's rate was 20 per cent in 1980s to the early 1990s (Park and Rhee, 2005). With this general trend, what is evident is the *ten* percentage point difference between the household saving rates of USA and Japan at the take-off stage. Apart from the economic factor of GDP growth, why is there such difference at similar development stage? Is there a hidden cultural dimension underlying household saving?

Studies to research the cultural dimension of household savings have been very limited. Carroll, Rhee and Rhee's (1994) study of migrants' saving in Canada find no evidence that cultural factors influence saving behavior. However, they indicate that the conclusion must be viewed as tentative, as they do find some plausible cultural effects; for example, Asians spend more on education than other migrants. In a later study, Carroll (2006) notes that culture partly influences saving, and 'it seems natural to expect that countries whose saving rates are high because of a cultural preference for saving would consequently exhibit high growth (Carroll, 2006)'. He goes further by stating that the precautionary motives and habit formation are important in a model to explain the pattern of saving and growth in the East Asian 'tiger' economies.

Economic development is a complex phenomenon shaped by economic, social institutions, as well as culture. The cultural factor alone does not explain

all of the variations in growth rates or saving rates, instead cultural and economic factors should be seen as playing complementary roles (Granato et al., 1996). Weber (1930) explained the rise of capitalism as cultural influence rooted in the Protestant work ethic. In the World Value Survey (See Figure 2) across 25 countries, Granato et al. (1996) find that China, Japan and Korea score higher in cultural values on teaching children 'thrift' than the teaching of traditional social norms of 'obedience' and 'religious faith'. Whereas the USA and UK emerge with relative lower levels on teaching children 'thrift' .

**Figure 2 Economic growth rate by achievement motivation scores of publics**



Source: Granato, Inglehart, and Lebang, 1996, p.612.

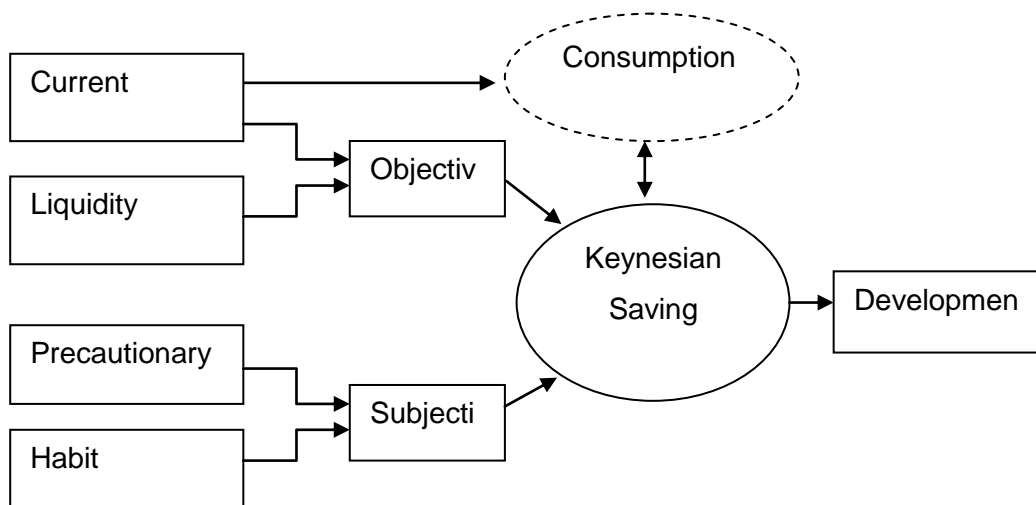
The cultural differences can be seen in the context of developed economies such as USA, UK and Australia having a Western Christian cultural heritage<sup>ii</sup>, compared to East Asian economies such as China, Japan and South Korea with Confucian cultural influence (Harrison and Huntington, 2000). In this context, the cultural influence on China's household saving is set against Western cultural heritage as a reference point. What arise from this comparison are the two aspects to the problem of household saving: the trade-off between saving and consumption in the consumption driven model for China's next higher development stage; the issue of culture in economic analysis of saving.

The significant theories on saving include: Rostow's stages of development, Keynesian saving, Post Keynesian saving theory, Modigliani's Life Cycle Hypothesis (LCH) and Friedman's Permanent Income Hypothesis (PIH). The

stages of development theory, the Keynesian saving, LCH, and PIH emphasize the economic, social determinants of saving, but do not take into account the cultural determinants. Post Keynesian saving theory accounts for habit and social norms and presents a progressive step towards broader analysis of China's household saving incorporating culture. Although these theories are referred to as modern theories on saving, they were initially developed at least over 50 years ago (Smith, 1993). In the current economic environment, human capital is playing an increasingly significant role in development. There needs to be a clear institutional element in the analysis to explain such developments. There are two strands of economics that provide a door through which this research can analyze culture and saving. One is Keynesian economics, with Keynes ([1936], 1973) saving providing an appropriate theoretical grounding. The other is Institutional Economics, which frames the research within institutional and cultural elements.

According to Keynes, saving is determined by disposable income (Keynes, [1936], 1973). Keynes explains that as income increases, both consumption and saving will increase. However, the increase in consumption will be less in proportion than the increase in income, because of economic actors' habits, norms and psychological disposition (Keynes, [1936], 1973). For Keynes, saving is a leakage from the circular flow of income, *ceteris paribus* leading to reduction in effective demand.

**Figure 3. Key determinants of saving in Keynesian saving theory**



Keynesian saving categorizes the factors influencing saving as objective and subjective. The objective factors include 'disposable income and liquidity constraints'; and the subjective factors include 'precautionary motive and habit formation' (Keynes, [1936], 1973). The objective economic factors of income and liquidity constraints tend to converge across cultural groups; and the cultural factor of precautionary motive and habit formation are subjective, they are the manifestation of the social norms and cultural rules of diverse groups, and they are embedded in institutions as culture is defined in Institutional Economics (Hodgson, 1988, North, 2005). Consistent with Keynesian saving as

a leakage, Steindl (1982) argues that household saving, by not consuming, adversely affects business profits and economic growth.

North (2005) articulates that *uncertainty*, *human intentionality* and *path dependence* are key concepts in explaining the process of economic change. The above concepts help in framing the analysis to the saving question. For New Institutional Economics (NIE), uncertainty is a constant in explaining institutional change; human intentionality refers to the deliberate effort of humans to try to shape their future; how human societies attempt to shape their future is fundamentally influenced by the history. How the past connects with the present and future is the concept of path dependence. These concepts are consistent with the OIE notions of uncertainty and path dependence, and they are relevant in the analysis of China's household saving. NIE assumes economic agents' decisions are influenced by uncertainty; however, it differs from the OIE in that NIE assumes rationality, while OIE rejects this assumption. Historical events (path dependence) such as war, hardship or lack of it affects different generations in their motivation, choice and action (human intentionality) in terms of saving which will shape their current and future outcomes.

Consistent with Post Keynesian economics, Galbraith's institutional empirical perspective on consumption and saving in the 1950s proves relevant for contemporary China. Galbraith ([1958], 1984) advocates for social balance, and balance of public and private goods provision. This concept relates back to the need for long term balance between consumption and saving discussed earlier. Courvisanos (2005) takes this concept of balance further in a Post Keynesian eco-innovation policy towards sustainable development, but the role of saving in this system has not been mapped out.

The factors influencing saving decision are multiple and complex. Much research on saving is done on the economic, social or financial dimensions; addressing the cultural dimension has significance for sustainable development.

### 3. Five emerging themes

In a practical sense, cultural value is non-observable and it is impossible to isolate the cultural mechanism (Tu, 2001) from the economic, social mechanisms which influence China's household saving. However, it aims to isolate it in the thought process. Through the comprehensive literature review of saving and culture, themes emerge in the context of China's household saving. The *cultural* influence encompasses: family structure (Zhou, 2009), saving for children's education (Beijing Review, 2009), reluctance in using consumer credit<sup>iii</sup> (Woetzel et al., 2009), teaching thrift (Granato et al., 1996), precautionary motive (Carroll, 2006) and habit formation (Carroll, 2006).

Five themes of the cultural aspects of China's household saving are:

- (i) precautionary motive to buffer against income uncertainty, Chinese household save for healthcare, retirement, etc.;
- (ii) habit formation, which means saving increases faster than consumption as income increases, as household consumption habit is relatively stable;

- (iii) use of consumer credit, including bank loan for housing or non-housing credit; the Chinese refer credit as future money;
- (iv) investment in education, saving for children's education expenses;
- (v) teaching thrift, to teach children to 'save money and things' (Granato et al., 1996).

The above concepts have been referred to in studies on saving (Carroll, 2006), Chinese consumers (Woetzel et al., 2009), culture and economic development (Granato et al., 1996). However, putting these concepts together in the analysis of culture and household saving is new. The first two concepts originate from Keynesian saving theory; this paper extends these two concepts to Chinese household saving context and incorporates three new concepts.

With depleting natural capital and scarce physical capital, the need to cultivate the human capital, particularly the cultural capital is increasingly significant in knowledge economy. The knowledge generated will provide a basis for strategic guidance to harness the cultural capital Zhong Yong - the Golden Mean of balance in the context of household saving for China's future development.

#### 4. Analytical framework

Figure 4. Analytical framework of the interplay between culture and saving

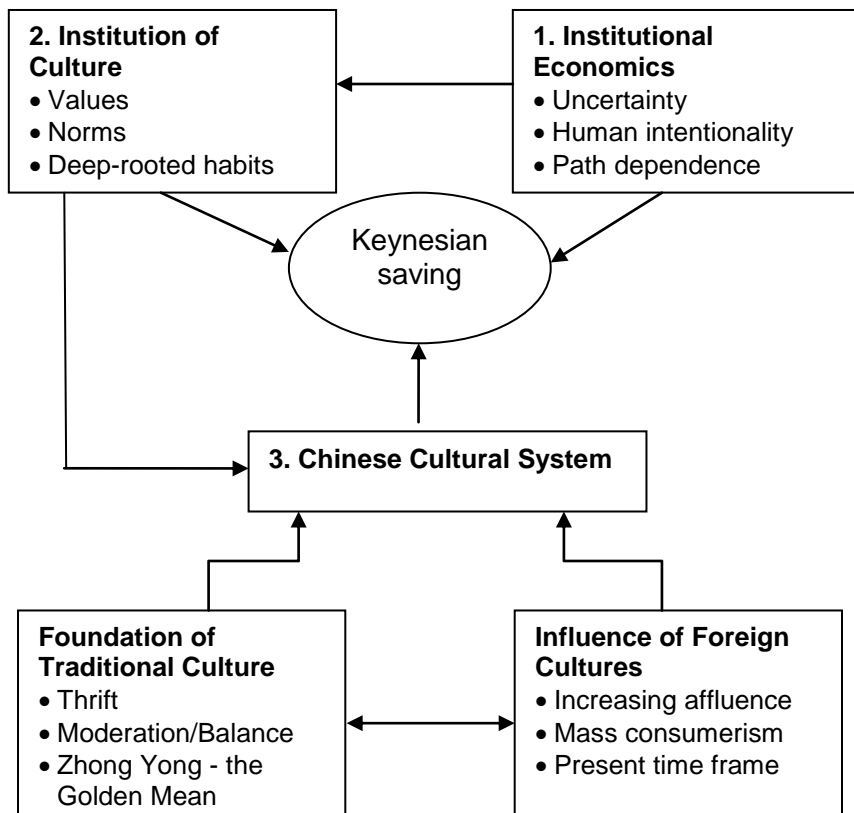




Figure 4 presents the analytical framework for researching cultural influence on China's thought revealed in the literature review (Zhang and Courvisanos, 2010). It centers on Keynesian saving (See Figure 2), consisting three other components. There is no single established theory to encompass all of the cultural aspect of China's household saving. Keynesian saving theory at the center of the framework links to Institutional Economics concepts. The framework illustrates a dynamic process as cultural influence on household saving is complex and dynamic. In the first component of the Institutional Economics, concepts of uncertainty, human intentionality and path dependence capture how economic agents deal with the institutional aspect of saving decisions. They link to the cultural values, norms and habits of the institution of culture in the second component. In the third component of the Chinese cultural system (Lu, 2009), the Chinese traditional culture and the influence of foreign cultures impact on China's household saving and the evolution of saving. The tension between tradition and modernity will emerge. The framework aim to address the question: How does culture influence China's household saving?

This analytical framework is developed with a notion of reviewing the past events to understand the present better; it is framed with a vision for forward looking into options for China's future sustainable development.

## **5. Conclusion and implication**

This paper provides an initial exploration of the cultural influence on China's household saving and culture's role in sustainable development. From the comprehensive literature review, there are several conclusions that can be drawn. Firstly, we can see emerging patterns by analyzing the past trends in household saving rates of selected economies, the historical cycle of saving indicates that household saving rates increase significantly in the stage of economic take-off, and generally taper off or decrease in the higher stages of maturity and mass consumption. This cycle was evident in the case of the USA, Japan, South Korea; it may be present in the future case of China, although there are still puzzles in this issue to be resolved.

Understanding the comprehensive picture of China's household saving is fundamental in providing strategic guidance in its sustainable development, this is the role of the analytical framework developed from the diverse literatures on saving, consumption and sustainable development. In addition to the economic factors, cultural factor influences China's household saving, specifically in terms of precautionary motive, habit formation, use of consumer credit, saving for children's education and teaching thrift. Theses cultural values, norms and deep-rooted habits are shaped by the traditional Confucian value of Zhong Yong – the Golden Mean, which strives for balance in consumption and saving. As Li (Beijing Review, 2009) implicates the differences in consumer cultures as a primary contributor in China's high household savings. To endure prosperity, it is important to make adjustment of consumption in overall economic structure by encouraging sustainable consumption and use of savings for investment in eco-innovation systems. The latest Government move towards increase in public provision on health care, social security (Baldacci et al., 2010) should provide an additional approach to balancing consumption and saving

sustainably. It is significant in China's development path in the twenty-first century towards social and cultural development, paying attention to 'institutional, social and cultural capital' (Wang and Hu, 2007), that rapid economic growth is adjusted towards sustainable development, and the analytical framework developed in this paper is a small contribution to the debate in China for such a development path.

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<sup>i</sup> Steindl (1982, p.70) defines net aggregate household saving as the sum of the net household financial saving (deducting credit and mortgage) plus real investment in dwelling housing. Since this paper is focusing on the influences on decisions of individual households, the focus is on the net household financial saving.

<sup>ii</sup> Western cultural heritage (economies such as UK, USA and Australia) is narrowly identified in the context of saving as different from economies with the Confucian cultural heritage (China, Japan, Korea) as per Harrison and Huntington (2000) and in teaching thrift as per Granato and Leblang (1996).

<sup>iii</sup> Consumer credit refers to bank mortgage loans for housing or non-mortgage credit for big-ticket items such as furniture or electronics.