

Saving and Investment in China: A Flow of Funds analysis

Jo Michell

Ph.D. Candidate, Department of Economics, School of Oriental and African Studies, University of London.

This paper provides an in-depth analysis of the relationships between saving and investment; the distribution of income; and banking and financial sector intermediation during the recent period of very high growth rates in China.

It is argued that discussions of China's growth and income distribution based on a conceptualisation of the economic system centred on neoclassical marginal productivity theory and aggregate production function approaches will yield faulty conclusions. An alternative method is put forward, based on a Kaleckian growth model wherein investment is the primary driver of the dynamics of economic growth.

It is argued that the 'loanable funds' analysis of saving and investment which is usually deployed in discussions of the Chinese growth phenomenon is deficient, leading to an emphasis on the saving behaviour of households as the key factor that determines the high overall rate of saving and growth in the Chinese economy. Instead, if the investment decisions of firms are viewed as taking the active role, with finance provided by the banking system, saving should more correctly be seen as adjusting passively to those investment decisions. In such a system, the significance of the saving propensity of households will be manifested primarily through its influence on the profitability of the firm sector.

The discussion is illustrated with a detailed analysis of the Chinese flow-of-funds accounts. The flow-of-funds accounting system allows for an empirical methodology that stands in contrast to the dominant approach of econometrics based on aggregate production functions. Using this framework, the 'financial balances' that arise from the discrepancy between real saving and investment within sectors can be connected with the flows of financial assets and liabilities that offset these real sector imbalances. The way that these flows are conditioned by the actions of the monetary authority is examined in the context of the high rate of monetary sterilisation that is the result of the current account surpluses. It is demonstrated that the most significant form of saving dynamics in the Chinese economy takes place in the firm sector in the form of retained earnings, with household saving of decreasing significance.