

Should China encourage consumption

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Despite the view that China saves too much and hence exports too much, causing global imbalances, it is argued that the high saving rates in China can be explained by rational economic factors. A simple three-period model of intertemporal optimal savings is used to show that, under a wide range of plausible parameter values that are likely to fit the current Chinese situation, very high saving rates may be utility maximizing. Moreover, while there are valid behavioural reasons for encouraging savings, there are no valid grounds for encouraging consumption. However, it may well be true that China exports too much even for its own interest by undervaluing the RMB by too much and by ignoring the environmental costs of production. Our analysis implies that it is probably better for China to contribute towards solving the global imbalances by significantly revaluation of its currency rather than by artificially encouraging consumption.