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Under-Consumption, Trade Surplus, and Income Inequality in China

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Abstract

It has recently been shown that rising income inequality had contributed to increase in savings of the rich and decrease in consumption of the poor, pressuring politicians to permit cheap loans for the poor from the rich. The resultant lending boom created a massive run-up in the housing prices and ensuing mortgage crisis in the US. In China, capital markets are underdeveloped and the poor may not be able to borrow from the rich. Employing Chinese provincial panel data and a variety of estimators, we find that rising income inequality significantly lowers consumption and, consequently, raises China's current account surplus.

Keywords: Income inequality; Under-consumption; Trade surplus; China

JEL classification: E21, O15, O53

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