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Halvor Mehlum, Ragnar Torvik, Simone Valente



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The Savings Multiplier

Halvor Mehlum^a, Ragnar Torvik^b and Simone Valente^{c*}

^aUniversity of Oslo ^bNorwegian University of Science and Technology ^cUniversity of East Anglia

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Abstract

A theory of macroeconomic development based on the novel concept of *savings multiplier* is developed. Capital accumulation changes relative prices, amplifying incentives to save as the economy grows. The savings multiplier hinges on two mechanisms. First, accumulation raises wages and leads to redistribution from the consuming old to the saving young. Second, higher wages raise the price of old-age care and, in anticipation of this, the young save more. Our theory captures important aspects of China's development and suggests new channels through which the one child policy and the dismantling of social benefits have fueled China's savings rates.

Keywords: Intertemporal choices; China's savings puzzle; Overlapping generations.

JEL classification: O11, D91, E21

*Corresponding author: Simone Valente, School of Economics, University of East Anglia, Norwich, United Kingdom. Email: s.valente@uea.ac.uk.

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