THE SPIRIT OF CAPITALISM, SAVINGS, ASSET PRICES AND GROWTH

Chapter VII

The Spirit of Capitalism and a Resolution of the Savings Puzzles

Saving was for old age or for your children; but this was only in theory—the virtue of the cake was that it was never to be consumed, neither by you nor by your children after you.

—John Maynard Keynes, The Economic Consequences of the Peace.

What determines savings? This has been a major issue of macroeconomics since the publication of Keynes’ General Theory (1936). Major breakthrough in understanding savings based on consumer utility maximization was achieved in 1950s by the life-cycle hypothesis of Franco Modigliani and Richard Brumberg (1954) and the permanent-income hypothesis of Milton Friedman (1957). For many years, countless studies were devoted to test and refine these two hypothesis. But since the 1970’s, many empirical studies have suggested that the life-cycle theory of consumption cannot explain the “savings puzzle”: why wealth does not decumulate after retirement, and why wealth holdings tend to increase with age (Atkinson, 1971; Atkinson and Harrison, 1978; Mirer, 1979; Thurow, 1976; Danziger, et al., 1984). Moreover, Kotlikoff and Summers (1981) demonstrat that the pure life-cycle component of aggregate U.S. savings has been very small and that most capital accumulation in the US occurs through intergenerational transfers. Like the life-cycle model, however, the theory of intergenerational transfer cannot fully explain why there exists no significant difference in the rate of asset decumulation between the elderly who have children and those who do not, which is shown by Hurd (1986); nor can it explain why there exists a positive relation between transfers and recipient’s income as demonstrated in Cox (1987).
This chapter proposes a possible solution to these anomalies by applying the capitalist-spirit model to an overlapping-generations framework. This extended model makes it possible to incorporate the standard intertemporal savings and bequest motives as special cases. But in this new framework, the empirical evidence already reported in the literature can be reinterpreted from this more general point of view. The present approach is strictly complementary to the existing life-cycle theory and the theory of bequest. My contribution is to explain the part of savings which cannot be explained when the capitalist spirit is not incorporated. In other words, there are three motives for savings: for retirement, for bequest, and accumulation for its own sake. Or just as Wicksell (1934, 1977) has emphasized: savings "depend on a number of motives - partly selfish, partly altruistic, but in any case very complex. People save for themselves, but also for their successors. Some people often save merely for the pleasure of saving. Exceptional people may save and accumulate capital simply because they cannot help themselves". (pp. 207-208)

VII.1 The Capitalist Spirit In An Overlapping Generations Model of Savings

Consider a typical agent of the i-th generation who lives for two periods. He consumes \( c_{i1} \) in period 1 and \( c_{i2} \) in period 2, saves \( w_{i1} \) in period 1 and \( w_{i2} \) in period 2, and derives a discounted utility over the two periods:

\[
    u(c_{i2}) + \beta v(w_{i1}) + \frac{u(c_{i2}) + \beta v(w_{i2})}{1 + \delta},
\]

(7.1)

where \((1 + \delta)^t\) is the positive time discount factor; \(\beta v(.)\) is the utility derived from wealth accumulation itself and the parameter \(\beta\) is used to measure the capitalist spirit, and can take any value from zero to positive infinity. [I exclude negative values of \(\beta\) or Wittgenstein's view that money is a nuisance (Russell, 1958, p. 144).] When \(\beta\) equals zero, this is the standard utility function as in Diamond (1965); when the
term \( \delta v(w_{t,1}) \) is dropped for the first period but retained for the second, this is the standard bequest models like Blinder’s (1973). It is further assumed that both functions \( u(.) \) and \( v(.) \) are increasing, concave and differentiable in their arguments: \( u'(.) > 0, v'(.) > 0, u''(.) < 0, \) and \( v''(.) < 0. \)

For simplicity, population growth is assumed to be zero. I normalize the number of individuals in each cohort to be one. Thus generation \( i \) or agent \( i \) receives an amount of wealth \( w_{t+1,i} \) from the generation \((t-1)\). This wealth is left behind by agent \((t-1)\), while the old generation has already derived the discounted utility \( (1+\delta)^t \beta v(w_{t+1,i}) \) from the holding of wealth \( w_{t+1,i} \). In addition to the wealth left over by the old generation, individual \( i \) receives an income \( y \) when he is young. Again for simplicity, this income is assumed to be the same for all generations and the interest rate on savings is also fixed at a constant \( r \) for all generations. Therefore, we can write the budget constraint for the typical generation \( i \) as follows:

\[
\begin{align*}
    w_{t,1} &= y + (1+r)w_{t-1,2} - c_{t,1}, \\
    w_{t,2} &= (1+r)w_{t,1} - c_{t,2}.
\end{align*}
\]

Here equation (7.2) says that generation \( i \)'s total income \( y + (1+r)w_{t+1,i} \) is allocated between first-period consumption \( c_{t,1} \) and first-period savings \( w_{t,1} \). Equation (7.3) says that the total first period savings plus the interest income is used for the second period consumption \( c_{t,2} \) and the second period savings \( w_{t,2} \).

Maximizing (7.1) subject to (7.2) and (7.3) yields the first-order conditions:

\[
\begin{align*}
    \beta v'(w_{t,2}) &= u'(c_{t,2}), \\
    \beta v'(w_{t,i}) + \frac{(1+r)}{(1+\delta)}u'(c_{t,2}) &= u'(c_{t,1}).
\end{align*}
\]
Expression (7.4) implies that the marginal utility of consumption and the marginal utility of savings in the second period are equal at optimum. Condition (7.5) indicates that, if consuming one unit at period 1, its utility is given by $u'(c_{i,1})$; if saving one unit, its marginal utility comprises two parts: the marginal utility from period 1's savings $\beta v'(w_{i,1})$ and the marginal utility of the second period consumption weighed by the time discount rate and the interest rate; at optimum, period $i$'s marginal utility of consumption equals the marginal utility of savings in period 1 and period 2.

Combining (7.2)-(7.5), savings in periods 1 and 2 can be expressed as:

$$\beta v'(w_{i,2}) = u'((1+r)w_{i,1}-w_{i,2}).$$ \hspace{1cm} (7.6)

$$\beta v'(w_{i,1}) + \frac{(1+r)}{(1+\delta)} \beta v'(w_{i,2}) = u'(y + (1+r)w_{i-1,2}-w_{i,1}).$$ \hspace{1cm} (7.7)

Differentiating $w_{i,j}, j = 1,2$, with respect to $\beta$, I obtain:

Proposition 7.1: The higher the capitalist spirit, the higher the savings in both periods 1 and 2.

Proof: Differentiating with respect to the capitalist-spirit parameter $\beta$ in (7.7) and (7.8) yields:

$$\frac{dw_{1,1}}{d\beta} = \frac{\beta v''(w_{1,2})u''((1+r)w_{i,1}-w_{i,2})}{\Delta_w} > 0,$$

$$\frac{dw_{1,2}}{d\beta} = \frac{u''(c_{i,2})(1+r)[v'(w_{i,1})+\beta v'(w_{i,2})]+v'(w_{i,2})[\beta v''(w_{i,1})+u''(c_{i,2})]}{\Delta_w} > 0,$$

where

$$\Delta_w = -u''(c_{i,2})(1+r)^2 \beta v''(w_{i,2})-\beta v''(w_{i,2})(\beta v''(w_{i,1}+u''(c_{i,2}))[\beta v''(w_{i,1})+u''(c_{i,1})] < 0.$$

$$b = (1+r)(1+\delta)^{-1}.$$ \hspace{1cm} QED.

Rearranging optimal conditions (7.4) and (7.5), I have:
\[
\frac{\nu'(w_{l,1})}{\nu'(w_{l,2})} = \frac{u'(c_{l,1})}{u'(c_{l,2})} \frac{(1+r)}{(1+\delta)}.
\]

(7.8)

From which, the movement of the wealth ratio \(w_{l,1}/w_{l,2}\) can be seen:

**Proposition 7.2:** Savings increase (decrease) with age, that is, \(w_{l,1}/w_{l,2} < 1\) (\(w_{l,1}/w_{l,2} > 1\)), if the marginal rate of substitution between consumption in period 1 and consumption in period 2 is larger (smaller) than \((2+r+\delta)/(1+\delta)^i\).

The proof comes directly from expression (7.8). Suppose that \(w_{l,1}/w_{l,2}\) is less than one, that is to say, savings in the second period are higher than in the first period. Then the left-hand side of equation (7.8) is larger than one since the function \(\nu(.)\) is concave. To maintain equality, the right-hand side has to be bigger than one, which means that the marginal rate of substitution between consumption in period 1 and consumption in period 2 minus \((1+r)/(1+\delta)^i\) is larger than one, or the marginal rate of substitution is larger than \((2+r+\delta)/(1+\delta)^i\). The proof of the other case is similar.

From proposition 7.2, we can see the movement of consumption in the two periods corresponding to changes in savings. If the wealth ratio \(w_{l,1}/w_{l,2}\) is less than, or equal to, one, the marginal rate of substitution \(u'(c_{l,1})/u'(c_{l,2})\) is greater than, or equal to, \((2+r+\delta)/(1+\delta)^i\), which is greater than one. Then, by concavity of \(u(.)\), the ratio of the consumption in period 1 over that in period 2, \(c_{l,1}/c_{l,2}\), is less than one, or \(c_{l,1} < c_{l,2}\). This observation leads to:

**Proposition 7.3:** If second-period savings are larger than, or equal to, first-period savings: \(w_{l,2} \geq w_{l,1}\), then second-period consumption is no less than first-period consumption: \(c_{l,2} \geq c_{l,1}\).

In order to see the effect of the capitalist spirit on the wealth ratio clearly, let \(u(c) = \log c\) and \(\nu(w) = \log w\). Then, the first-order conditions become:
\[
\frac{\beta}{w_{i,2}} = \frac{1}{c_{i,2}}, \quad (7.9)
\]

\[
\frac{\beta}{w_{i,1}} + \frac{(1+r)}{(1-\delta) c_{i,2}} = \frac{1}{c_{i,1}}. \quad (7.10)
\]

Substituting (7.9) into the budget constraint (7.3):

\[
\frac{w_{i,2}}{w_{i,1}} = \frac{(1+r)\beta}{1+\beta}. \quad (7.11)
\]

This gives:

**Proposition 7.4:** Second-period savings are higher (less) than first-period savings if \(r\beta > (\delta)J\) or if the capitalist spirit \(\beta\) is larger (smaller) than \((1/r)\).

In this special case, Proposition 7.2 can be strengthened:

**Proposition 7.5:** The ratio of savings over the two periods, \((w_{i,2}/w_{i,1})\), increases in the capitalist spirit \(\beta\).

That is,

\[
\frac{d}{d\beta}\left[\frac{w_{i,2}}{w_{i,1}}\right] = \frac{(1+r)}{(1+\beta)^2} > 0. \quad (7.12)
\]

I continue to use the special case to illustrate the path of wealth accumulation or savings over time and from one generation to another generation. Using the budget constraints (7.2) and (7.3) and the first-order conditions (7.9) and (7.10), I obtain the following relation between second-period savings of the \(i\)-th generation and second-period savings of the \((i-1)\)-th generation:

\[
w_{i,2} = \frac{(1+r)(2+\delta)\beta^2 + \beta(1+r)[y+(1+r)w_{i-1,2}]}{(1+\beta)^2(2+\delta)}. \quad (7.13)
\]
From this, it follows that:

Proposition 7.6: When the capitalist spirit is strong, each generation will bestow more and more wealth to the next generation.

That is,

\[
\frac{d\omega_{1,2}}{d\omega_{1-1,2}} \rightarrow (1+r)^2 > 1 \text{ for large values of } \beta.
\]  

(7.14)

VII.2 Empirical Evidence

VII.2.1 Savings Behavior of the Old in Empirical Studies

According to the standard life-cycle theory of savings, old people are supposed to decumulate their wealth after retirement. But from the perspective of the capitalist-spirit model, savings in old age can be higher than in young age as suggested by propositions 4 and 5. This theoretical result has strong support in empirical studies on the savings behavior of the old since the 1970s.

Atkinson (1971) and Atkinson and Harrison (1978) show that average wealth accumulation in Britain increases in old age. Brittain (1978) finds a positive relationship between age and wealth holdings in the United States. Mirer (1979) examines wealth holding patterns among aged married couples from the 1968 survey of the Demographic and Economic Characteristics of the Aged and finds that wealth (not including the capital value of pensions, social security, etc) declines modestly, or perhaps not at all, with age. This observation not only applies to the very rich, but also holds for all other levels of wealth. Furthermore, after correcting for intercohort differences in wealth at retirement, he shows that wealth increases with age. Menchik and David (1983) also fail to show individuals decumulating wealth in old age, and, on the contrary, the opposite result seems to hold in their study. As for the saving rate, Thurow (1976) finds positive saving rates for all age groups. Danziger et al (1983) show that the elderly not only do not dissave to finance their consumption during retirement, they spend less on consumption goods and
services (save significantly more) than the nonelderly at all levels of income. Moreover, the oldest of the elderly save the most at given levels of income.

Intergenerational transfers have been used to explain this increasing relationship between wealth and age. But empirical studies have cast some doubt on this motive. According to the bequest theory, children with low income should receive more transfer income from their parents than the children with high income from the same family. But statistical studies have shown the opposite. For example, Sussman et al (1970), Brittain (1978) and Menchik (1980) all have found that wealth bequeathed to children is shared equally, while Cox (1987) finds a positive relation between the transfers and the recipient's income.

All these facts are consistent with the capitalist-spirit model of savings. Since savings themselves also generate utility, the old keep saving even though the life-cycle motive tends to reduce savings. Furthermore, as strong capitalist-spirit-minded parents may encourage their children to have the same spirit, they will give equal or more money to those children with a strong capitalist spirit and high income than to their children with low income. This positive association between recipients' income and bequest also points out that the parents have tried to encourage industriousness and savings of their children. It is extremely surprising that Montesquieu (1748, 1899) has already emphasized the relationship among frugality, hard work, and equal share of inheritance as a principle in a democracy: "In a commercial republic, the law giving all children an equal portion in the inheritance of the fathers is very good. In this way, whatever fortune the father may have made, his children, always less rich than he, are led to flee luxury and work as he did." "Certainly, when democracy is founded on commerce, it may very well happen that individuals have great wealth, yet that the mores are not corrupted. This is because the spirit of commerce brings with it the spirit of frugality, economy, moderation, work, wisdom, tranquility, order and rule." (p. 48)
VII.2.2 Savings Behavior of Households with and without Children

Perhaps the most important challenge to the bequest theory of savings, and a more significant piece of supporting evidence for the capitalist-spirit theory of savings, comes from Hurd (1986). One may expect that the bequest motive depends on whether the old have children. But, with the data from the Longitudinal Retirement History Survey (RHS), Hurd finds that households with children and without children do not show any significant difference in their dissavings. In fact the opposite is true: "the households with children have less bequeathable wealth than households without children. If the observed rates of decumulation continue beyond the ages of the RHS households, the households with children will always have less wealth than households without children" (p. 32-33). Hurd also finds that the saving rates of the households without children are always higher than the saving rates of the households with children. While Hurd's finding challenges the bequest motive of savings, it implies that savings can be undertaken for the sake of savings regardless of whether a household has children or not. Hurd hints that the existing methods cannot be used to study the savings behavior of the very wealthy: "If one wants to understand how the capital stock is accumulated, one would probably want to study the very wealthy. However, the standard consumption models may not apply: time constraints prevent the very wealthy from consuming even the interest from their wealth" (p. 35). The capitalist-spirit theory of savings seems to offer an alternative to the existing models of savings.

VII.2.3 Savings Psychology of the Rich

The rich have most of the wealth in most countries. For example, in Britain, the top 1 percent of the adult population own about a third of the total personal wealth and the top 10 percent as much as three-quarters (Atkinson, 1971, p. 239). Empirical studies have demonstrated some different patterns of savings for the rich. Burbridge and Robb (1985) show that, among Canadian households, there exists a
significant difference in accumulation behavior among the rich and the poor; on average, "blue-collar" households decumulate after retirement and "white-collar" do not.

While it is difficult to offer a regression analysis about the savings behavior of the very rich and the "captains of industry", their savings habit and their "spirit of accumulation" can be seen from their confessions and many case studies. The first example is taken from Weber (1958):

"When Jacob Fugger, in speaking to a business associate who had retired and who wanted to persuade him to do the same, since he had made enough money and should let others have a chance, (they are the followers of the life-cycle theory, added), rejected that as pusillanimity and answered that 'he (Fugger) thought otherwise, he wanted to make money as long as he could.'" (p. 51).

Many examples are presented in Sombart's (1915) book. For example, Sombart cites Andrew Carnegie's autobiography: "We were always hoping ... that there would come a time when extension of business would no longer be necessary; but we invariably found that to put off expanding would mean retrogression." (p. 174) He also quotes Rockefeller: "The more the business grew the more capital we put into it, the object being always the same: to extend our business." (p. 174)

Having studied the money-making careers of many "captains of industry", Sombart offers the following observation on their savings psychology: "It frequently happens that he really does not want to expand further, but he must. Many a captain of industry has confessed as much.... Most capitalist undertakers think nothing else but this desire for extension and expansion, which to the outside observer appears so meaningless" (pp. 174-175). This expansion psychology leads to ever-increasing savings. If you interpret their behavior as saving and investing for the future or for next generation, captains of industry will quickly dismiss this intention and "regard you with a kind of mild surprise" (p. 175).

Wicksteed (1933) has the following description of the savings psychology of the rich:

A millionaire is not only able to save but unable not to save, because he cannot spend all his accumulation at once, and he is always able to transmute present
into future command of wealth. (p. 294). Indeed to the rich man the problem often is how he can avoid saving too much. The exigencies of his business may drain him of his income. It is always demanding to be extended, till he no longer controls it, but it controls him. It has become a kind of Frankenstein’s monster that dominates his life. It must grow or die. And he cannot let it die, partly because he is dependent upon it, and partly because it has become a kind of entity to him, and, independently of all the things in the circle of exchange that it represents to him, has acquired a kind of independent claim upon his affection and his imagination, and is bound up with all manner of personal relations and obligations. (p. 298)

VII.2.4 The Connection Between the Capitalist Spirit and Savings Over Time

The role of the capitalist spirit in the economic take-off from a traditional society to a modern capitalist economy is manifested in two aspects: first, the capitalist spirit contributes to a higher saving rate; and second, the capitalist spirit cannot be separated from entrepreneurship in the sense of Joseph Schumpeter as I have argued in chapter 2. As observed by Rostow (1960), the economic take-off from a traditional society to a industrialized society requires a significant increase in the saving or investment rate from about 5 percent of national income to about 10 percent. How does one explain this phenomenon? According to Weber and Sombart (see chapter 1), the attitudes towards acquisition, savings and wealth accumulation are very different between traditional society on one hand and capitalist society on the other. While in the traditional society the normal situation for mankind is that rationally acquisitive activities are oriented to a traditionally fixed standard of living and the saving rate is rather low, in the capitalist era, the traditional practice is broken down and acquisition has become an endless process. From the historical perspective, the Protestant ethic is the psychological origin of this capitalist spirit
because the Protestant ethic—hard work, thrift, austerity—"must have been the most powerful conceivable lever for the expansion of that attitude toward life which we have called the spirit of capitalism." These ethos also have direct implication for the rising saving rates: "when the limitation of consumption is combined with this release of acquisitive activity, the inevitable practical result is obvious: accumulation of capital through ascetic compulsion to save." (Weber, p.172, italics added.)

Mill (1848) paid particular attention to the puzzle between low returns and rapid accumulation in his time. His explanation emphasizes the role played by the spirit of accumulation. As long as the spirit of accumulation is strong, high returns are not needed to stimulate savings: "In England and Holland, then, for a long time past, and now in most other countries in Europe... the desire of accumulation does not require, to make it effective, the copious returns which it requires in Asia, but is sufficiently called into action by a rate of profit so low, that instead of slackening, accumulation seems now to proceed more rapidly than ever." (p. 175, italics added.)

Keynes (1920) also stresses the role of "the saving for the sake of saving" in the vast accumulation of capital in the 19th-century Europe. But he warns that this psychology is not stable if social and political conditions change: "It was not natural for a population, of whom so few enjoyed the comforts of life, to accumulate so hugely. The war (World War I, added) has disclosed the possibility of consumption to all and the vanity of abstinence to many. Thus the bluff is discovered; ... the capitalist classes, no longer confident of the future, may seek to enjoy more fully their liberties of consumption so long as they last, and thus precipitate the hour of their confiscation." (p. 19) Keynes' prediction in fact has been proved by history. While a strong capitalist spirit has led to rapid capital accumulation and fast economic growth, the waning of the capitalist spirit has been the main cause of the "British disease" as diagnosed by Sombart (1915), Henry Rosovsky [in Harrison (1992)], and Wiener (1982). Once the "captains of industry" have lost their wholehearted pursuit of money and profits, and once people have developed their contempt for the capitalist spirit, then a declining trend of savings and economic growth
is inevitable. While blaming large government deficits and borrowing as the main cause of very low saving rates in the US, Harrison (1992, also see chapter 3) is very careful to point out the fundamental change in the American cultural values. According to Harrison, the traditional American values such as hard work, frugality and austerity, namely, the strong capitalist spirit of America, have been eroded gradually, "disrespect for thrift and austerity, driven by increased focus on the present and reduced focus on the future, has a lot to do with our low national levels of savings and investment." (p. 230)

VII.2.5 The Confucianist Ethic of Frugality and High Saving Rates of East Asia

Many studies on high saving rates in East Asian countries and regions like Japan, Taiwan, South Korea, Singapore and Hong Kong have taken the capitalist-spirit approach modified to the Confucianist ethic of frugality. In explaining the economic success of Japan, Morishima (1982) places the Confucianist ethic of frugality on equal footing with the Protestant ethic: while the Protestant ethic is the origin of the capitalist spirit in the West, the Confucianist ethic of frugality is the origin of the capitalist spirit in Japan (see details in chapter 3). Japan's story is not exceptional. South Korea, Taiwan, Singapore, Hong Kong and mainland China have followed the Japanese example. As observed by Roderick MacFarquhar (1985), for all these countries, "the significant coincidence is culture, the shared heritage of centuries of inculcation with Confucianism. That ideology is as important to the rise of the East Asian hyper-growth economies as the conjunction of Protestantism and the rise of capitalism in the west." "Post-Confucian economic man works hard and plays hard, buys much and saves more." Since Morishima does not explain the Confucianist moral of frugality, I present some idea of the Confucianist teaching on frugality here. In addition, as Morishima has already made a strong case for Japan, I will focus on China and South Korea.

The Confucianist ethic of frugality is expressed in the doctrine of Confucius (born 552 B.C.), the founder of the Confucianist school. Since the early Han Dynasty (B.C. 206-220 A.D.) until
early 20th century, Confucianism was the official ideology of China. The adoption of Confucianism in Korea and Japan resulted in the Korean Confucianism and the Japanese Confucianism. Even today, the moral teachings in these countries and other countries like Taiwan, Singapore and Hong Kong all have their origin directly from Confucianism. In the most famous Chinese classic *The Analects* (1986, English edition), Confucius states the following moral codes on frugality:

The Master (Confucius) said, 'In guiding a state of a thousand chariots, approach your duties with reverence and be trustworthy in what you say; be frugal in spending and love your fellow men'. (Book I, 5)

Lin Fang asked about the basis of the rites. The Master said, 'A noble question indeed! With the rites, it is better to err on the side of frugality than on the side of extravagance'. (Book III. 4)

The Master said, 'Extravagance means ostentation, frugality means shabbiness. I would rather shabby than ostentatious'. (Book VII.36)

Frugality is not only advocated by Confucians, it is also the central part of the Taoist and Mohist schools, which are antithetical to the Confucian school. According to the Taoist founder, Lao Zi (551-479, B.C.), we have the following teaching on frugality as an art of governing a state:

In ruling the people and in serving heaven it is best for a ruler to be sparing. It is because he is sparing
That he may be said to follow the way from the start;
Following the way from the start he may be said to accumulate abundance of virtue;
When there is nothing he cannot overcome, no one knows his limit;
When no one knows his limit
He can possess a state;
When he possesses the mother of a state
He can then endure.
This is called the way of deep roots and firm stems
by which one lives to see many days

(The Tao Te Ching, Book Two, Chapter LIX)

Frugality is also regarded as one of the three treasures in Lao Zi's doctrine:
I have three treasures
Which I hold and cherish
The first is known as compassion,
The second is known as frugality,
The third is known as not daring to take lead in the empire;
Being compassionate one could afford to be courageous,
Being frugal one could afford to extend one's territory,
Not daring to take the lead in the empire one could afford to be
lord over the vessels.
Now, to forsake compassion for courage, to forsake frugality for
expansion, to forsake the rear for the lead, is sure to end in death.

(The Tao Te Ching, Book Two, Chapter LXVII)

According to Mo Zi, (c. 468 - c.367 B.C.), the founder of the Mohist school. "Those who
practice frugality will thrive" (On Frugality, Mo Zi, or The work of Mo Di). From the principle of
frugality, Mo Zi is against all forms of extravagance and indulgence. He sets a common standard for
simplicity in food, clothes, house and means of communication and advises people to refrain from useless
luxuries such as extra spending on rites, music and funeral. He provides us the following picture of his
ideal society:

The ideal "is not the primitive situation in which men lived in holes in the
ground and wore animal skins. It is the unadorned purely functional culture
created by the first sage-kings. They built house high enough above the ground
to avoid the damp, with walls sturdy enough to keep out the wind and cold,
roofs solid enough to keep out the snow, sleet, and rain, and inner walls high
enough to separate the sexes. They made houses convenient for living and not for show. They invented textiles to keep people warm in winter and cool in summer, and not for display. There was an abundance of necessities and complete absence of frills." (Schwartz, 1985, p. 154)

Thus, according to Mo Zi, the worthy men would live lives of the greatest simplicity. The rulers of a society should always avoid waste and excess because the rulers’ cultivation of luxury and display can be attained only through the impoverishment of the people.

We should never underestimate the moral force of frugality teaching in the Chinese traditional thinking, in particular, the Confucianist ethos of thrift. In China, for about two thousand years, Confucianism was the official ideology and the moral code of the common people. Due to the lack of a popular and dominant religion over the long history, the Confucianist teaching has been deeply implanted in people’s mind. This is true for China, Taiwan, Hong Kong, and Singapore, because all these countries have essentially the Chineses and Confucianist culture.

Confucianist ethic of frugality plays a very important role in promoting high savings in China. It is absolutely right to attribute fast economic growth in the past 15 years to economic reforms initiated by Deng Xiaoping. But why have the Chinese people with a low per capita income kept an average saving rate of 34%? Perhaps this is the reason why most experts on China and East Asia have advocated so much the role of Confucianist values in generating high saving rates and fast economic growth in those countries; see Harrison (1992) and many references in Harrison’s book.

The influence of Confucianism in South Korea deserves our attention. With the Founding of the Yi dynasty in 1392, Confucianism was declared the state religion. In many schools there were shrines for the worship of Confucius and his disciples, and Confucian ritual was encouraged in the court and at every level of society (Ro, 1989, p.1). In the 16th century, two great Neo-Confucian scholars, Yi T’oege (1501-70) and Yi Yulgok (1536-85) developed a system of Korean Confucianism. In this system,
hard work, profits and wealth accumulation have their great importance. In fact, Yi Yulgok "formulated the work ethic remarkably similar to the Protestant ethic" in Weber's thinking. "In Yulgok's view work is sacred, and the desire to accumulate wealth is a natural and beneficial instinct. Government, he believed, has no right to prevent the individual from reaping economic profit or accumulate wealth." (Ro, 1989, p.120)

VII.3 Conclusion

Our theoretical model which includes the life-cycle motive and the bequest motive captures the essence of wealth accumulation in a capitalist economy: accumulation for the sake of accumulation. It indicates that, with a strong capitalist spirit, people may not decumulate their wealth in retirement, but continue to accumulate generation after generation. The empirical evidence strongly supports the role of the accumulation motive. First, the old do not generally decumulate wealth during retirement. On the contrary, they tend to keep saving until they die. Second, households with and without children do not have significant differences in their savings behavior. Moreover, the capitalist-spirit model of savings realistically characterizes the savings behavior of the very wealthy, and explains why there is a significant upward jump in the saving rates when a traditional society becomes a modern capitalist economy. It implies that saving rates will be different across countries if the intensity of the capitalist spirit is different. In particular, the model sheds light on high saving rates in East Asian countries endowed with the Confucianist ethic of frugality.