

The Chinese Economy: A Critical Decade

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Standard Chartered Hong Kong Forum
15th March 2012

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Outline

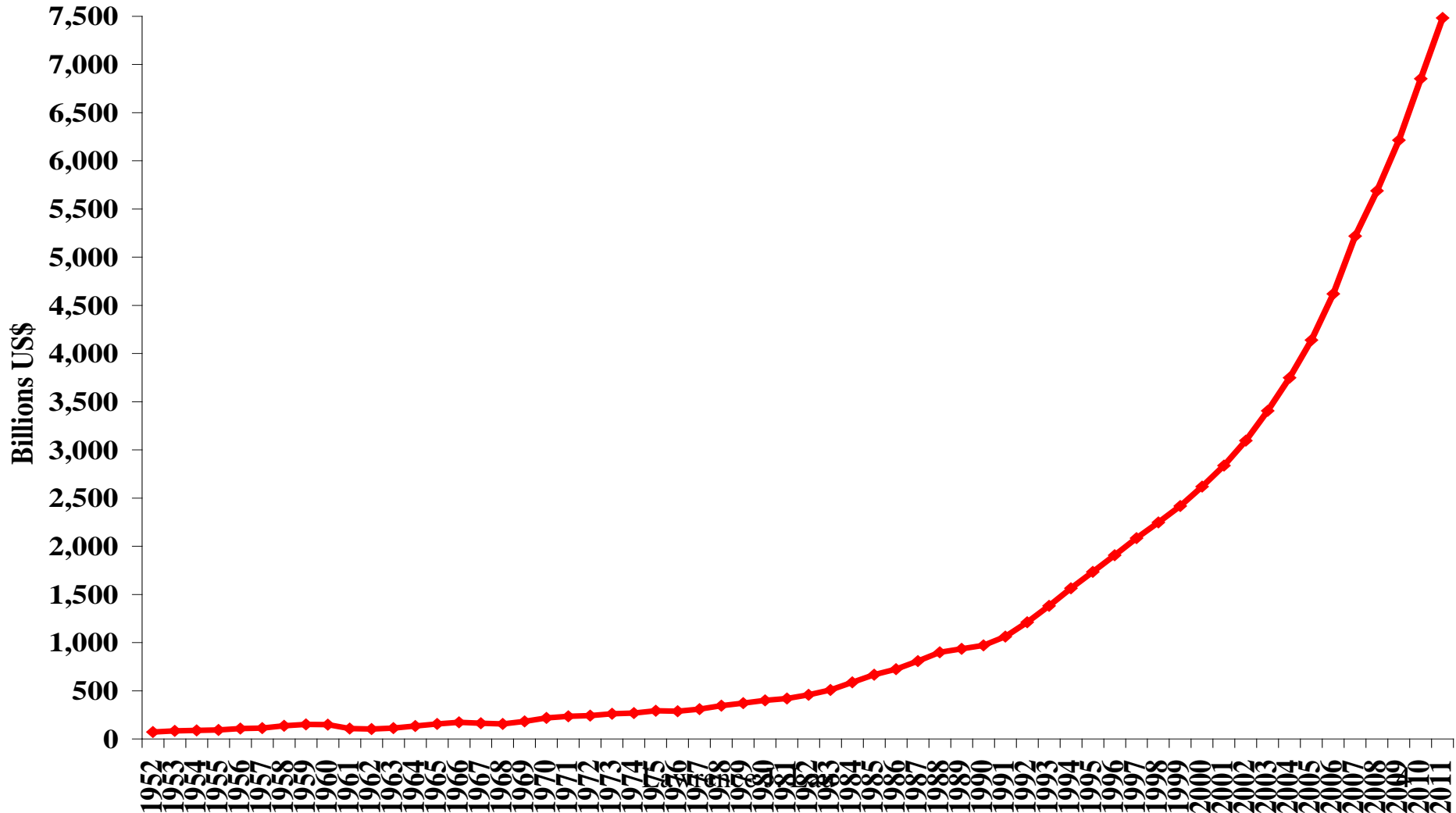
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Introduction

- ◆ China has made tremendous progress in its economic development since it began its economic reform and opened to the World in 1978. China is currently the fastest growing economy in the World—averaging 9.8% per annum over the past 33 years. It is historically unprecedented for an economy to grow at such a high rate over such a long period of time.
- ◆ Between 1978 and 2011, Chinese real GDP grew almost 22 times, from US\$344.8 billion to nearly US\$7.5 trillion (2011 prices) to become the second largest economy in the World, after the U.S.
- ◆ By comparison, the U.S. GDP (approx. US\$15.1 trillion) was 2 times Chinese GDP in 2011.

Chinese Real GDP in US\$ Since 1952 (2011 Prices)

Chinese Real GDP since 1952, in 2011 prices

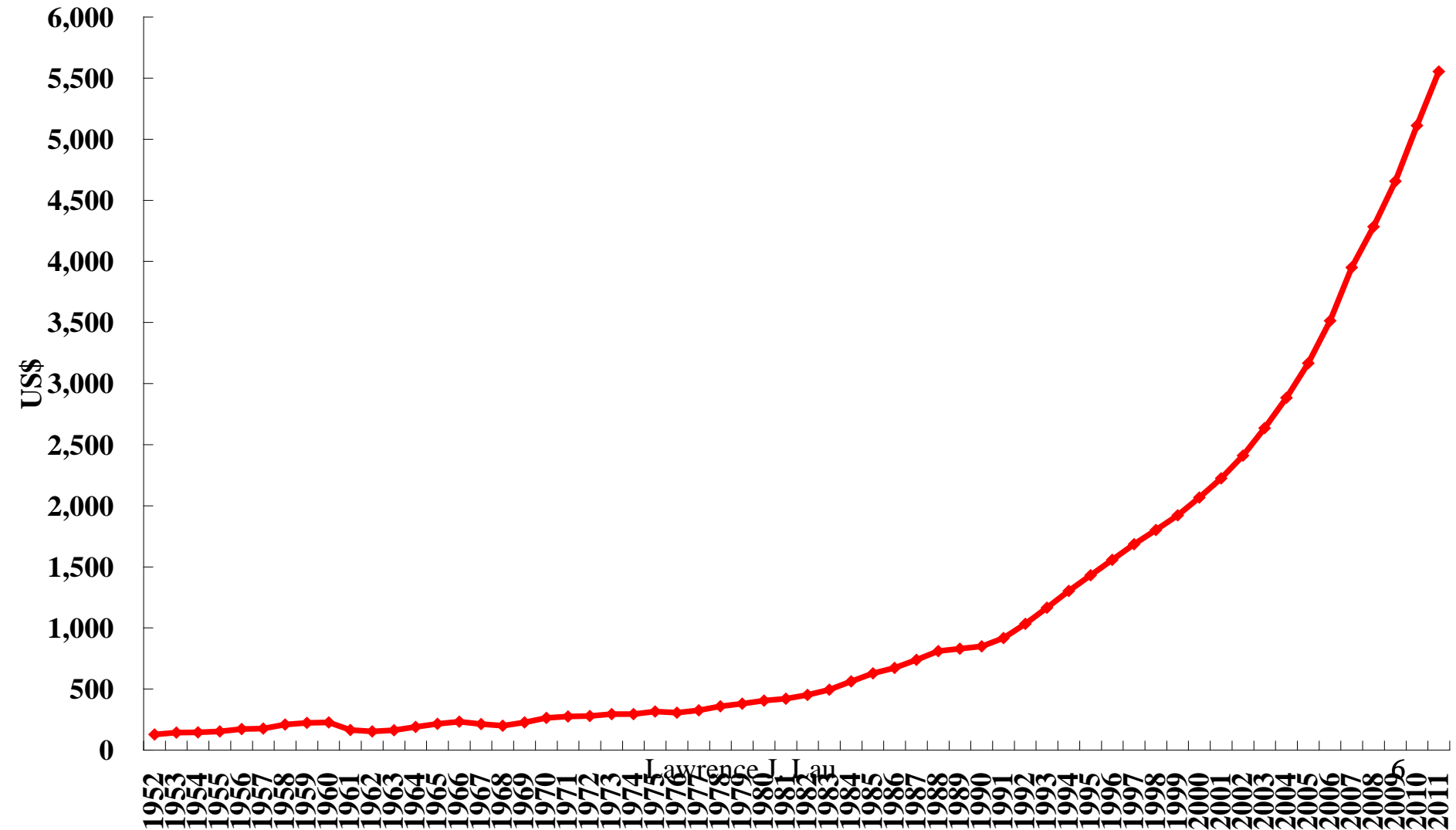


Introduction

- ◆ Despite its rapid growth, in terms of its real GDP per capita, China is still a developing economy.
- ◆ Between 1978 and 2011, Chinese real GDP per capita grew 15.5 times, from US\$358 to US\$5,555 (in 2011 prices). By comparison, the U.S. GDP per capita (approx. US\$48,236) was 8.7 times Chinese GDP per capita in 2011.

Real Chinese GDP per Capita in US\$ Since 1952 (2011 Prices)

Real Chinese GDP per Capita since 1952, in 2011 prices



Thirty years of Chinese Economic Reform

	Growth Rates	
	percent per annum	
	Period I	Period II
	1952-1978	1978-2011
Real GDP	6.15	9.79
Real GDP per Capita	4.06	8.66
Exports	9.99	17.32
Imports	9.14	16.63
Inflation Rates (GDP deflator)	0.50	4.24
	1952-1978	1978-2010
Real Consumption	5.05	8.88
Real Consumption per Capita	2.99	7.75

The Shifting Centre of Gravity of the World Economy

- ◆ The centre of gravity of the World economy is gradually shifting from the United States and Europe to Asia, including both East Asia and South Asia.
- ◆ The East Asian economies are partially de-coupled from the rest of the World economy, as evidenced by the strong performance of China, India and other East Asian economies during the 2007-2009 global financial crisis as well as the current European sovereign debt crisis.
- ◆ However, the Chinese and East Asian economies are not large enough to turn the World around. The idea of a G-2 consisting of the United States and China is premature.

The Twelfth Five-Year Plan for National Economic and Social Development

- ◆ The Twelfth Five-Year (2011-2015) Plan for National Economic and Social Development was approved by the National People's Congress in mid-March of 2011. It is mostly an indicative plan rather than a mandatory plan.
- ◆ The most remarkable feature was the lowering of the target growth rate from 7.5% per annum in the 11th Five-Year (2006-2010) Plan to 7% per annum. It is almost certain that this target will be exceeded, just as the target was exceeded in the last Five-Year Plan. However, what the reduction in the target growth rate signals is the determination of the Chinese Government to de-emphasise quantitative economic growth and to focus on the quality of the economic growth.

The Twelfth Five-Year Plan for National Economic and Social Development

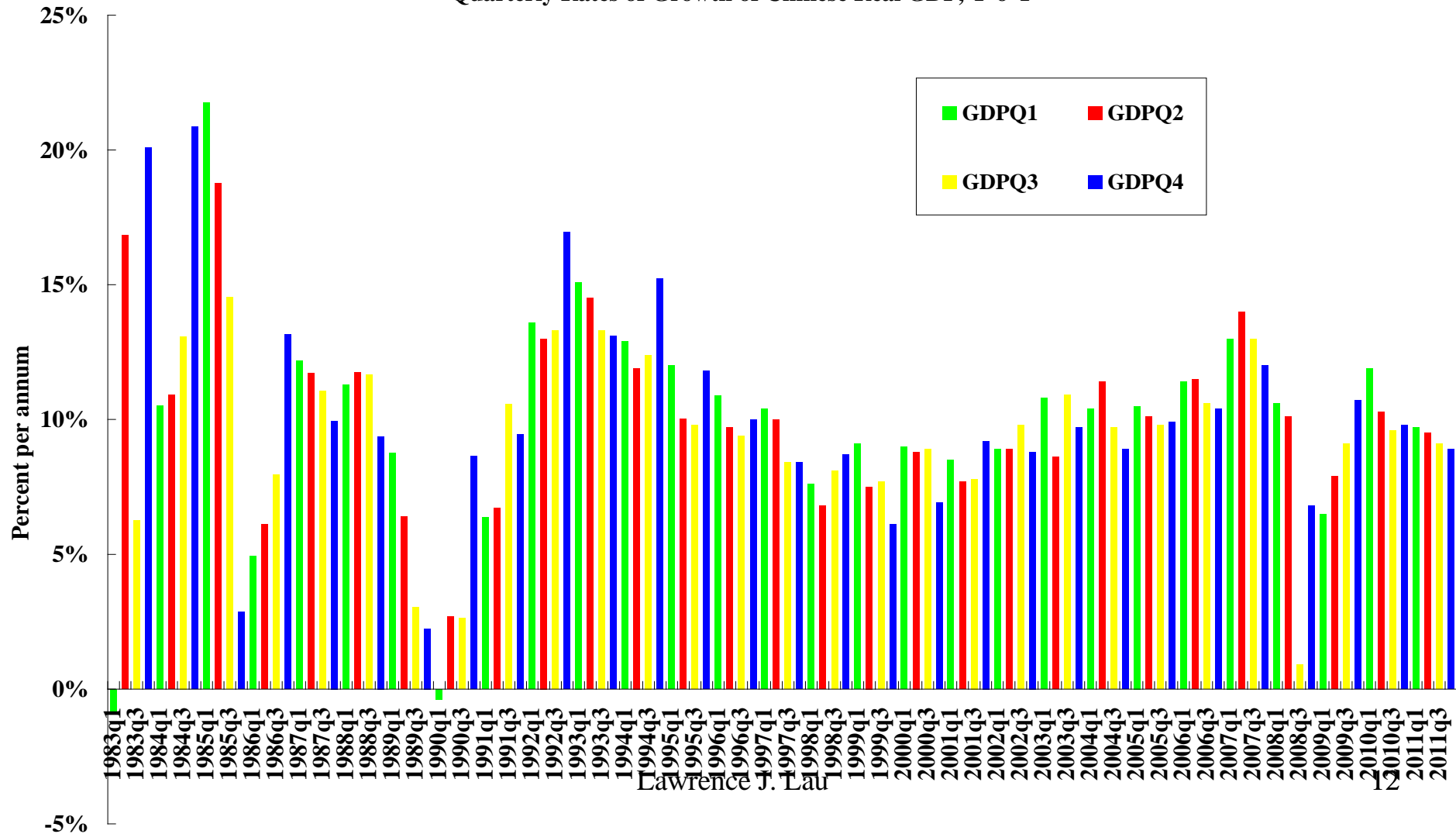
- ◆ One principal theme of the Twelfth Five-Year Plan is the transformation in the mode of Chinese economic development—firstly, from export-oriented to domestic demand-oriented and secondly, from input-driven to technical progress-driven or innovation-driven.
- ◆ The Plan also aims at essentially balanced international trade, which I believe is achievable.

The Macroeconomic Outlook

- ◆ The Chinese economy grew 9.2% in 2009, 10.3% in 2010 and 9.2 % in 2011 even as the European and U.S. economies remained in recession.
- ◆ The outlook is that there will be a gradual slowdown in the real rate of growth of the economy in 2012, to perhaps around 8%, which is actually a positive development for the Chinese economy. The official target growth rate, announced by Premier WEN Jiabao at the National People's Congress, is 7.5%.
- ◆ While 7.5% may seem like a significant reduction from 9.2%, there are reasons to believe that the impact of the economic slowdown on Chinese employment is not that severe.

Quarterly Rates of Growth of Chinese Real GDP, Y-o-Y

Quarterly Rates of Growth of Chinese Real GDP, Y-o-Y



The Macroeconomic Outlook

- ◆ For 2011 as a whole, the rate of inflation exceeded the objective of the Chinese Government of 4%, at 5.4%.
- ◆ The target for 2012 is to control inflation to below 4%.

The Critical Decade Ahead

- ◆ The new team, led by Vice-President XI Jinping, will take over the Chinese Communist Party in October and the Government in March 2013.
- ◆ It is expected to govern China for the next decade. It will have ten years to carry out the necessary reforms that will have long-term consequences.
- ◆ I have identified three critical areas of reform, in addition to changing the mode of economic development.

Critical Reform I: Reform of the Taxation System

- ◆ Introduction of the Property Tax
- ◆ Introduction of a Comprehensive Individual Income Tax
- ◆ Replacement of the Business Tax by the Value-Added Tax in the Service Sector

Critical Reform II:

Capital Control and Convertibility

- ◆ The Internationalisation of the Renminbi (rising use in the settlement of international transactions)
- ◆ Capital Account Convertibility—Distinguishing between Long-Term and Short-Term International Capital Flows
- ◆ The Social Counter-Productiveness of Short-Term International Capital Flows (increasing volatility of exchange rates and disrupting the real economy)
- ◆ The Introduction of a Tobin Tax on Foreign Exchange Transactions (with an exemption for current account, principally international trade in goods and services, transactions)
- ◆ Convertibility is not Equivalent to a Freely Floating Exchange Rate—China will most likely continue to maintain a managed floating exchange rate system

Critical Reform III:

Population and Retirement Policy

- ◆ The Chinese Population is Ageing Rapidly—rising life expectancy and falling birth rate (a consequence of one-child policy, urbanisation and education)
- ◆ Chinese population is projected to reach a peak in 2035 and will begin to decline absolutely
- ◆ The retirement age has not been changed to reflect the new realities
- ◆ Retirement provision is insufficient and not completely reliable (China should move to a centrally administered retirement fund system to enable labour and retiree mobility and change to a defined contributions rather than defined benefits system)
- ◆ The unequal treatment between urban and rural residents in terms of public goods such as education, health care and retirement benefits also needs to be further re-examined

Concluding Remarks

- ◆ The critical reforms mentioned above are not uncontentious and therefore require an administration with a long-term perspective and the political authority and will to undertake.
- ◆ The critical reforms mentioned above also require substantial preparation and a long time to become effective (for example, for population policy to have a real impact, it will take at least a generation). Thus they need to be introduced, advanced and implemented early as the new administration takes over.