China's Economic Boom: Can It Last?

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Definition of an "Economic Boom"

- What is meant by an "economic boom"?
- An average annual real rate of growth of approximately 7%--not double-digit rates and not 8, 9 or 10%.
- At an average annual real rate of growth of 7%, the real GDP can almost double in 10 years, thanks to the power of compound interest.
- At this rate, Chinese per capita GDP will exceed US$10,000 in 2012 prices by 2020, achieving "moderately well-off" status.
- China will also reach the same level of aggregate GDP as the United States, US$28 trillion in 2012 prices, a couple of years before 2030 (assuming that the U.S. economy grows at an average annual real rate of 3.5% during the same period).

Favourable Supply Side Fundamentals

- The national saving rate in China, currently standing at approximately 45%, will remain high even though it is expected to decline gradually.
- The decline will be caused not so much by a decline in the saving rate of Chinese households, but by a decline in the saving rate of Chinese enterprises through increased distribution of cash dividends to shareholders, including both households and the government, or through reduced profits resulting from rising wages.
- Even with a decline in the national saving rate, the domestic saving should continue to be adequate to finance the domestic investment needs without relying on foreign investment and/or foreign loans.

Favourable Supply Side Fundamentals

- Surplus labour will continue to exist—In 2012, the agricultural sector employs over 30% of the Chinese labour force but produces only 10% of the Chinese GDP.
- There will not be a "real" labour shortage despite the decline of the "working-age population"—the existing retirement ages of 55 for women and 60 for men are too low given the lengthened life expectancy of the Chinese population. One possible compromise is to raise the retirement age to 65 but require senior executives to give up their administrative leadership positions at age 60.
- The "one-child policy" is already in the process of being modified, for example, a married couple of single children is allow to have two children. Further changes are possible but their effects will not be felt for another two decades or more.

Favourable Supply Side Fundamentals

- There are very significant returns to scale in the Chinese economy—both technological economies of scale as well as market economies of scale—that remain to be exploited.
- Intangible capital, that is, R&D capital, patents, other intellectual property such as brand names, are highly productive in a large economy because once the fixed cost of invention/innovation is amortised, the rest is almost all pure profit.

The Metaphor of the "Wild Geese Flying Pattern"

- The metaphor of the "wild-geese-flying pattern" of East Asian economic development over time, introduced by Professor Kaname Akamatsu (1962) suggests that industrialisation will spread from economy to economy within East Asia as the initially fast-growing economies, beginning with Japan, run out of surplus labour and face labour shortages, rising real wage rates, and quota restrictions on their exports.
- Thus, industrialisation spread from Japan to first Hong Kong, and then Taiwan, and then South Korea, and then Southeast Asia (Thailand, Malaysia, Indonesia), and then to Guangdong, Shanghai, Jiangsu and Zhejiang in Mainland China.

The Metaphor of the "Wild Geese Flying Pattern"

- This metaphor applies not only to East Asia but also to China itself. Within China, industrialisation first started in the coastal provinces, regions and municipalities. It has already begun to migrate and spread to other provinces, regions and municipalities in the interior—to Chongqing, Henan, Hunan, Jiangxi, Shaanxi and Sichuan. As the coastal provinces, regions and municipalities slow down in their economic growth, the central and western provinces, regions and municipalities will take their turn as the fastest growing areas in China. China as a whole will be able to maintain a relatively high rate of growth for many years to come.

Transformation of the Sources of Aggregate Demand

- Chinese economic growth has not been export-led for quite some time now. Exports can no longer be the principal driver of economic growth.
- First, Exports and export surpluses are both declining in Renminbi terms. Chinese trade surplus is less than 2% of GDP.
- Second, Chinese exports have a low domestic-value-added content.
- Third, export-oriented labour-intensive light manufacturing has been relocating from China to other economies such as Bangladesh, Cambodia, Indonesia, Vietnam and even Myanmar where the wage rates are lower.

Transformation of the Sources of Aggregate Demand

- It is a goal in the Twelfth Five-Year (2011-2015) Plan for China to achieve balanced international trade.
- Going forward, the gross value of exports may decline even as the domestic value-added content rises.
- China is a large continental country like the United States. Ultimately, exports as a percent of GDP should be relatively low, in the teens.

Transformation of the Sources of Aggregate Demand

- The rate of growth of real household consumption has been higher than the rate of growth of real GDP. For example, the rate of growth of real retail sales is 1.5 times the rate of growth of GDP. But the rate of growth of household consumption is not high enough to change the national saving rate appreciably.
- Without a significant increase in disposable household income, household consumption is unlikely to increase at a significantly higher rate.
- A potential source of a significant increase in household income as well as government revenue is a requirement for the publicly listed Chinese enterprises to declare and distribute significant cash dividends to their shareholders, including households and the government. This should also help to reduce non-essential and non-productive investment on the part of publicly listed Chinese enterprises.

Transformation of the Sources of Aggregate Demand

- Raising the minimum wage can increase the consumption of low-income households but there may be limits to the size of the increase in the minimum wage.
- A comprehensive income tax reform which integrates all personal income categories and lowers the tax burden on the low and middle income brackets but raises the tax rates on higher income brackets may also increase aggregate household consumption.
- A more ambitious approach is to consider structural adjustment of the levels of wages and salaries of public workers—the Chinese Government is the largest employer and has monopsony power on the determination of wage and salary levels—which will also affect the levels of wages and salary levels of all other workers.

Transformation of the Sources of Aggregate Demand

- The rate of growth of real gross fixed investment is around 20% per annum, much higher than the real rate of growth of household or personal consumption.
- The Chinese economy will remain investment-led for a while—including infrastructural investment, investment in urbanisation and in agricultural mechanisation, and investment in the supply of public goods (for example, clean air, clean water, clean earth, education and health care).
- It is a good thing that China has become environmentally conscious much earlier than say the United States and Japan in terms of their per capita real GDP.

Transformation of the Sources of Aggregate Demand

- There is significant room for the expansion of public consumption, or consumption of public goods, financed by the government, for example, the cleaning up of air, water and soil, and the environment in general, education, and health care, all of which will require both new investments and continuing public expenditures.
- The provision of public goods such as education, health care, clean environment, by the government can greatly increase the welfare of the average people. It is also an effective means for redistribution, and for narrowing the degree of inequality of the effective income distribution, say between the urban and the rural areas.

Concluding Remarks

- Yes. The “economic boom” defined as an average annual real rate of growth of approximately 7%, can last for another couple of decades