Prospects for Chinese Economic Growth in the Medium to Long Term

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Outline

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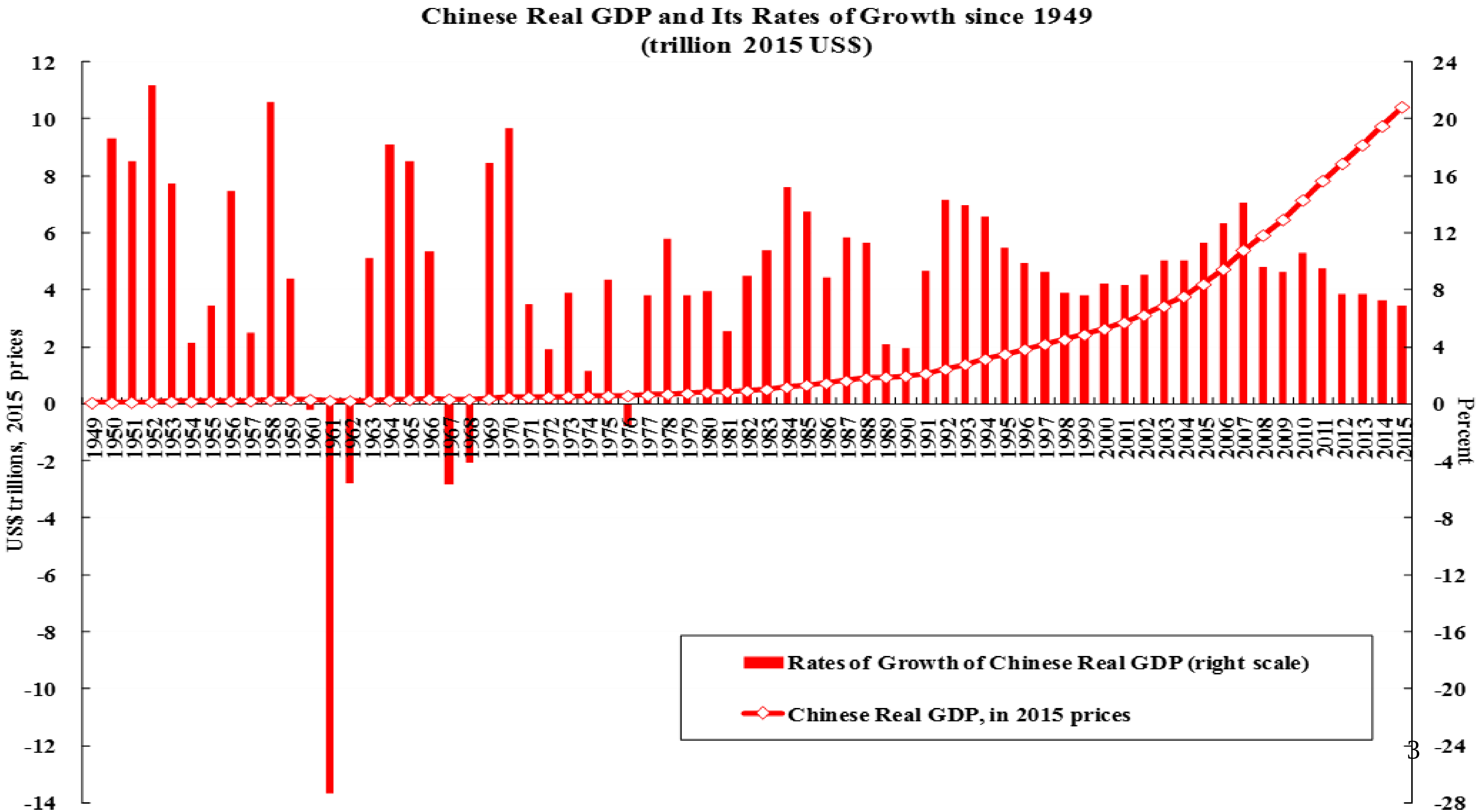
- Slowdown is Inevitable
- L-shaped Recovery Should be Viewed Positively
- China as a Surplus Economy
- Potential Sources of Aggregate Demand
- Projections of the Future
- Concluding Remarks

Historically Unprecedented Rates of Growth



Slowdown is Inevitable

- Elasticity of output with respect to an input

= Percentage change in output/Percentage change in input

- Rate of growth of output

= Output elasticity of labor . Rate of growth of labor

+ Output elasticity of capital . Rate of growth of capital

+ Technical progress (Rate of growth of total factor productivity (TFP))

- The rate of growth of labor (hours) eventually becomes negligible (or even negative) as the surplus labor runs out and the population takes more leisure.
- The rate of growth of capital eventually slows down as the capital stock becomes bigger and bigger through accumulation over time.
- Technical progress over the long term depends on cumulative investment in human capital and R&D and is unlikely to average more than 2 percent per annum.

- Moreover, significant improvements in economic welfare are not reflected in the GDP as conventionally measured, for example, more leisure and cleaner environment.

L-shaped Recovery Should be Viewed Positively

- L-shaped recovery is not necessarily negative. It all depends on where the horizontal part of the L is located.
- What the authoritative figure in the People's Daily article meant to convey is that there would be steady growth at around 6.5 percent per annum going forward, but no plan to pump up the economy back to a higher rate of growth through fiscal stimuli. There would be no V-shaped recovery, or for that matter not even a U-shaped recovery.

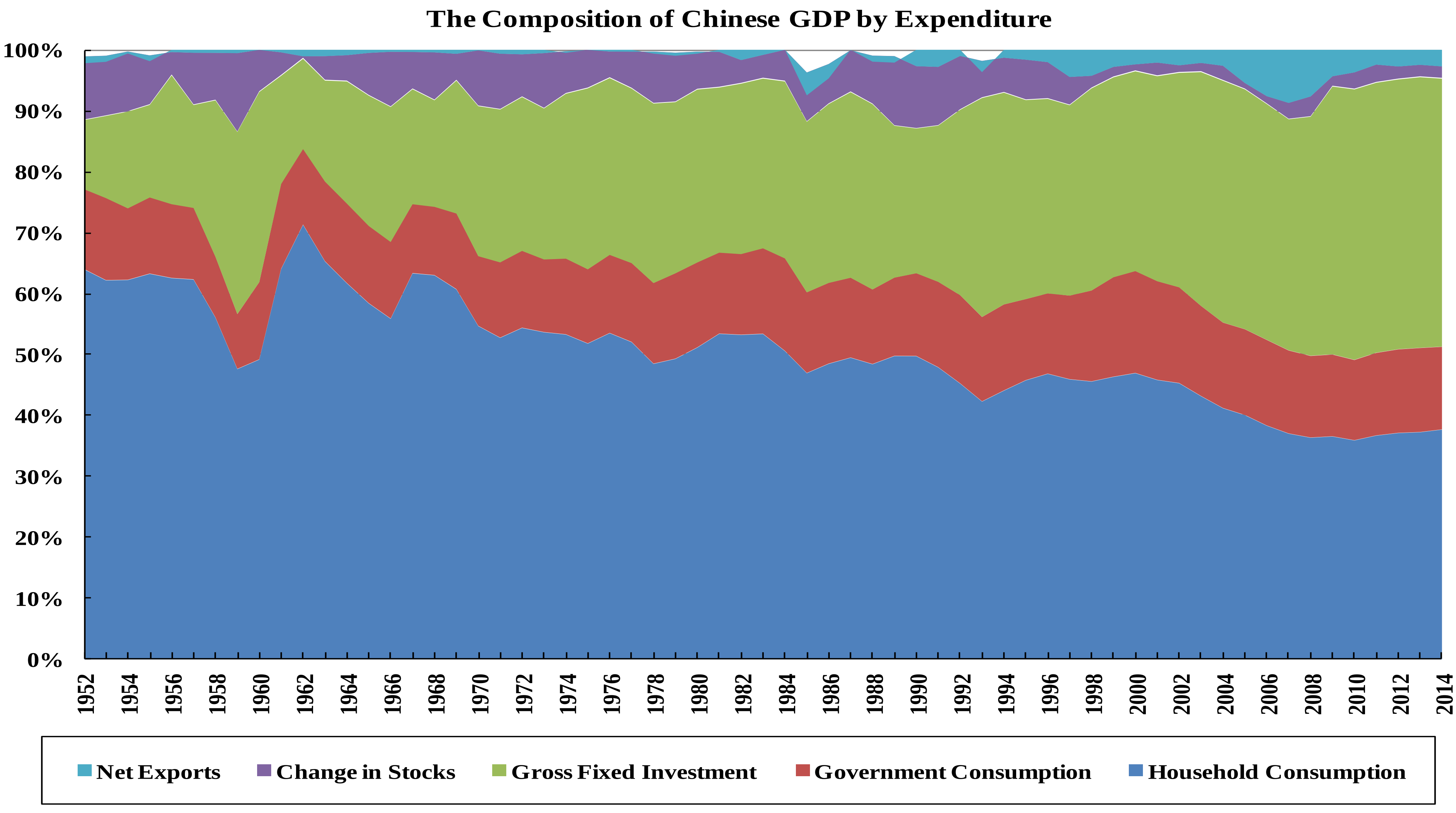
China as a Surplus Economy

- The Chinese economy today has so much excess capacity that supply is not a constraint. The constraint on output is aggregate demand. If there is demand, there will be supply.

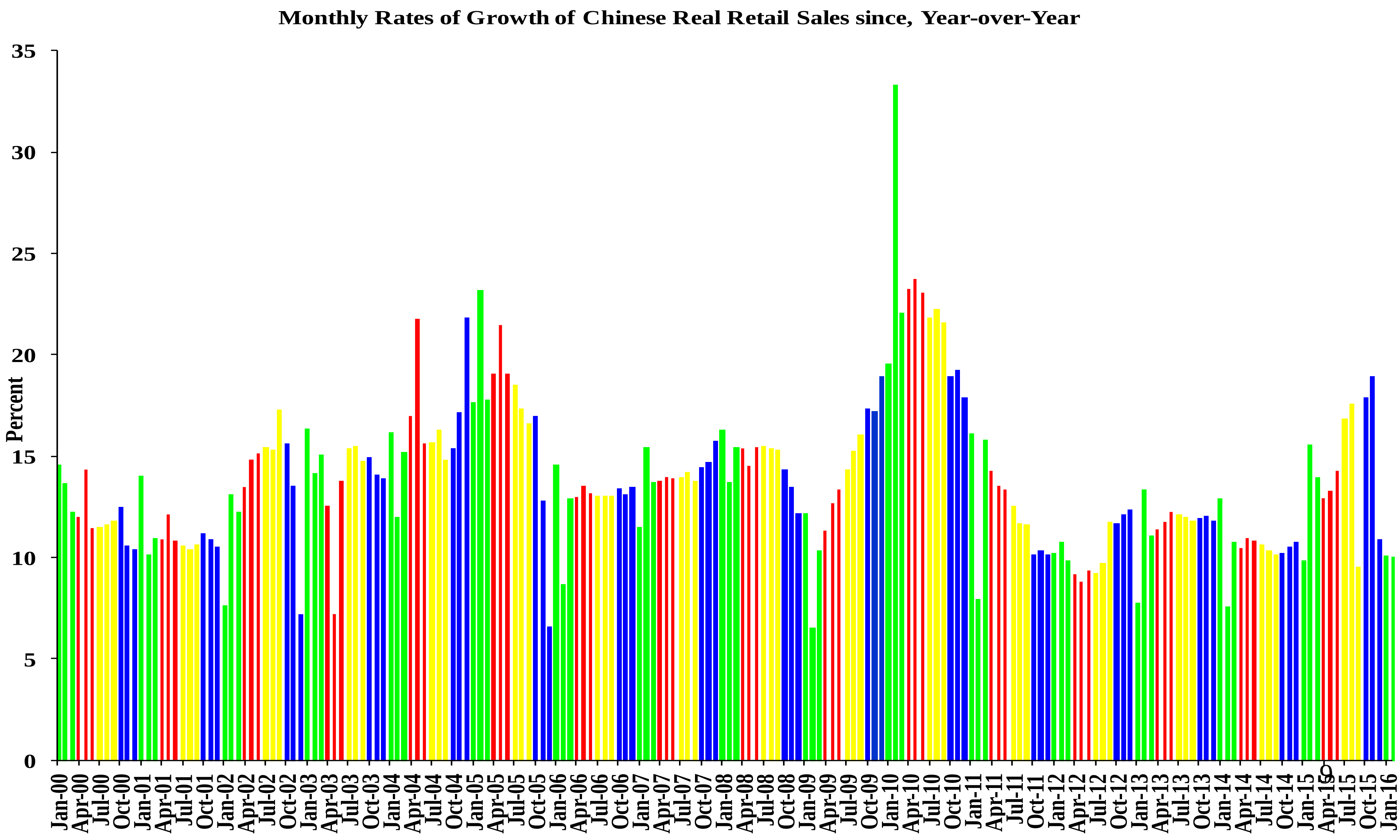
Potential Sources of Aggregate Demand

- The rate of growth of exports (and in particular that of the export surplus) has also been falling.
- The rate of growth of fixed investment has been falling, and rightly so, in view of the excess production capacity in many manufacturing sectors and in residential housing in other than first-tier cities (part of the supply side reform)
- Even though the rate of growth of real household consumption has been growing at approximately one and a half times the rate of growth of real GDP, it alone is not enough,.
- Public infrastructural investment such as high-speed railroads, urban mass transit systems and other urban public works, public Wi-Fi towers, affordable housing and clean energy.
- Investment in R&D.
- Public goods consumption (education, health care, elderly care, and environmental protection, preservation and restoration—clean air, water and soil).
- Universal access to the internet and the improvement of the environment is a de facto redistribution of income because both the rich and the poor will benefit equally from the improvements in the environment.

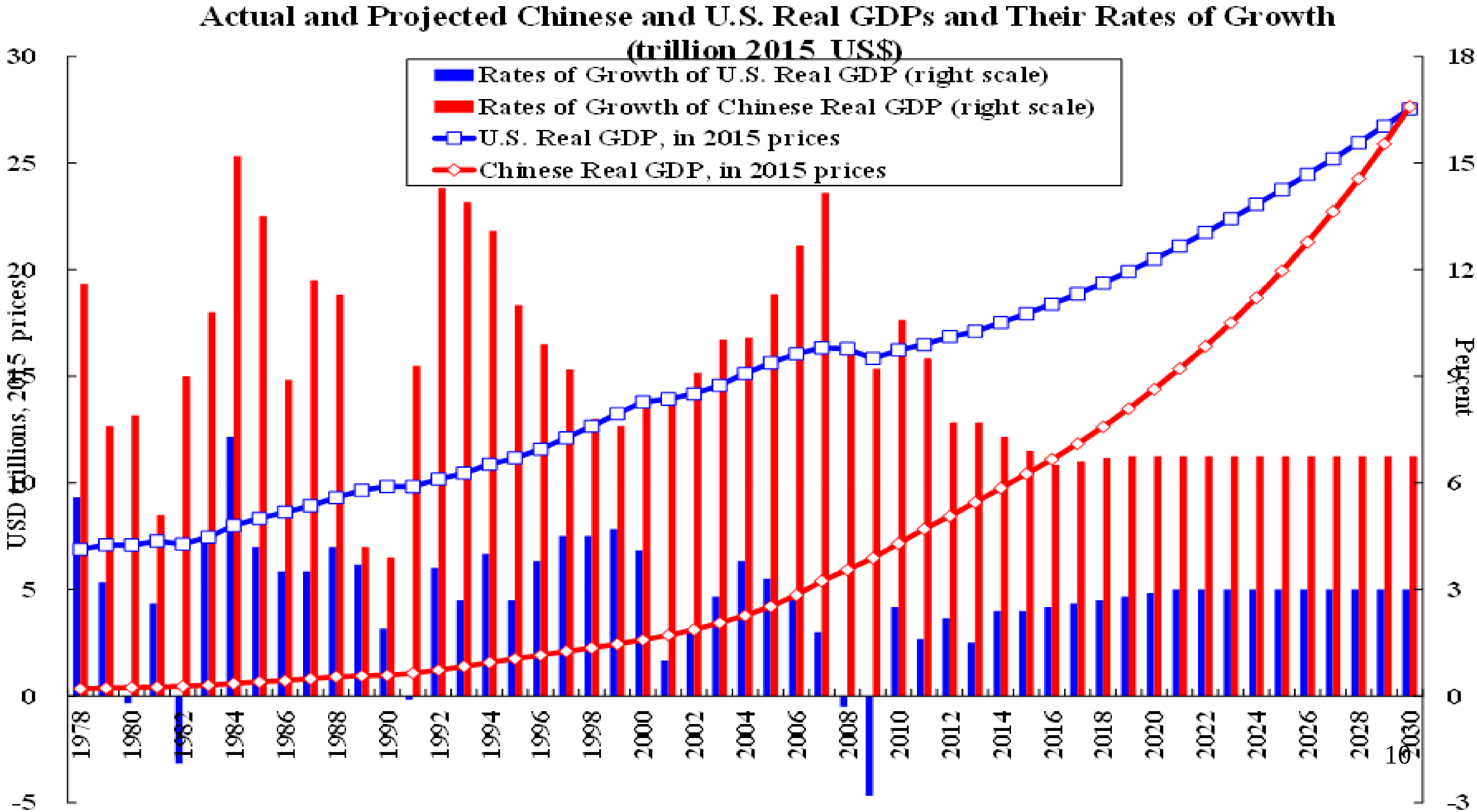
The Composition of Chinese GDP by Expenditure



Monthly Rates of Growth of Chinese Real Retail Sales, Y-o-Y



Projections of the Future



Concluding Remarks

- The Chinese economy should be able to grow at an average annual rate of between 6 and 7 percent for the next decade or even longer.
- There is excess productive capacity and as long as there is demand, there will be supply.
- The Chinese government has many instruments at its disposal and is pragmatic enough to use any or all of them if necessary.
- The Chinese labor supply will not be a constraint as the retirement age is lengthened and the transfer of surplus labor from the agricultural sector to the industrial and service sector continues.
- Continuing growth in human capital, tangible capital and R&D capital relative to the growth in labor should continue to enhance the growth of productivity in the Chinese economy.