

# China's Economic Situation and the Role of the State

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# Topic

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- The role of stimulating policy
- The evolution of industrial structure
- Industrial restructuring
- The role of the state

# 1. The Role of Stimulating Policy

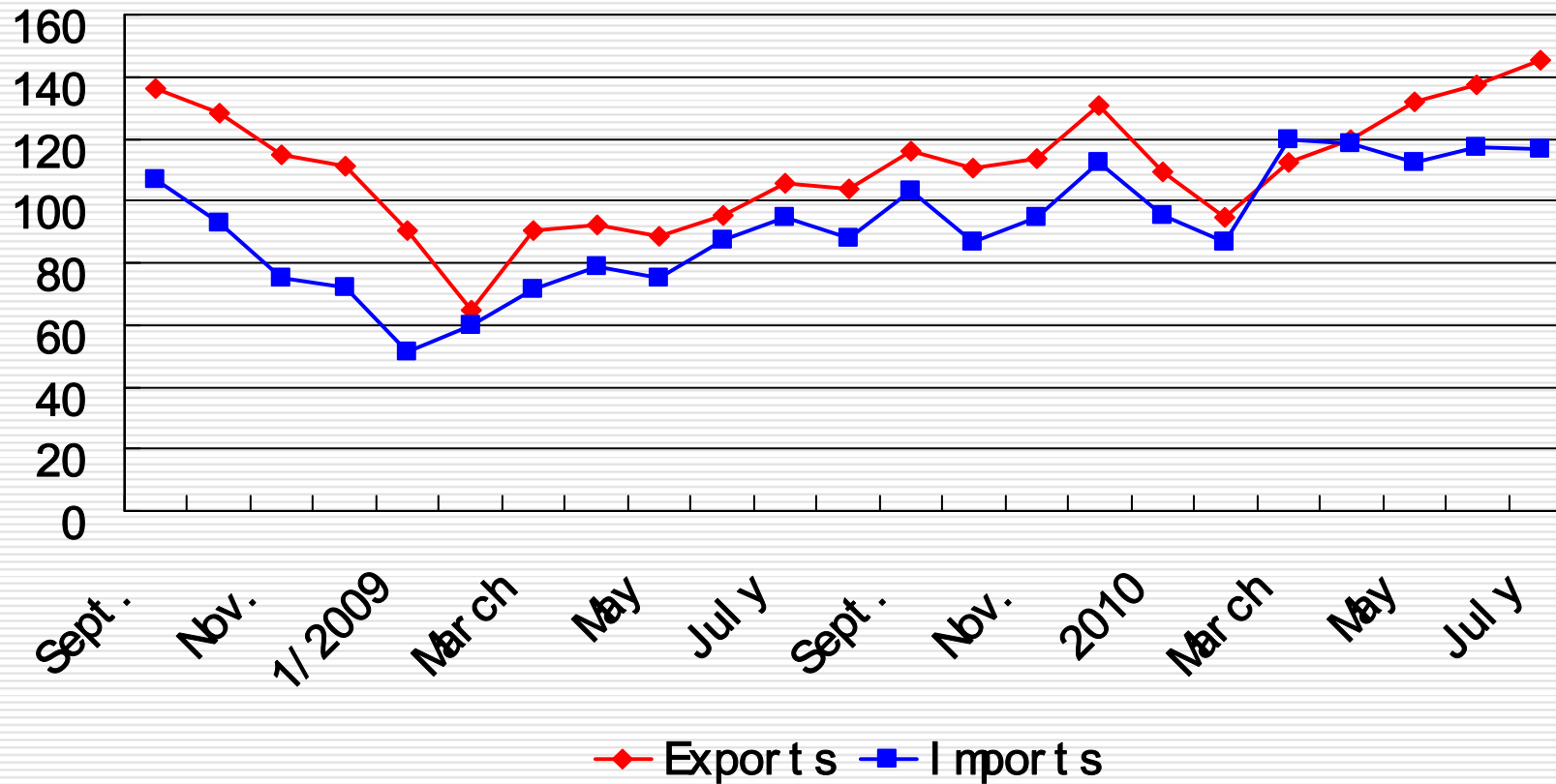
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- In response to the global financial crisis, China's stimulus package had been announced in October 2008, and unimaginably carried out in the past two years.
- Beyond the scale of RMB 4 trillion investments within one year.

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- How to understand and assess the real role of this stimulating package?
  - What results have been visible in China's development?
  - What kind risk may be happened or not?

# A. Exports and Imports, 09/08-07/10

USD billion



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- Exports (USD1.20 trillion) and imports (USD1.00 trillion) contracted by 16% and 11.2% in 2009 respectively.
  - The story is pretty clear. China's trade recovery has been V-shaped.

# Diversification of China's Exports

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- ❑ Demand from the industrialized countries is still weaker.....
- ❑ As emerging markets continue to recover in 2010, this will be positive for China's exports.
- ❑ Exports should grow 15-20% in 2010.

## B. Strong Domestic Consumption

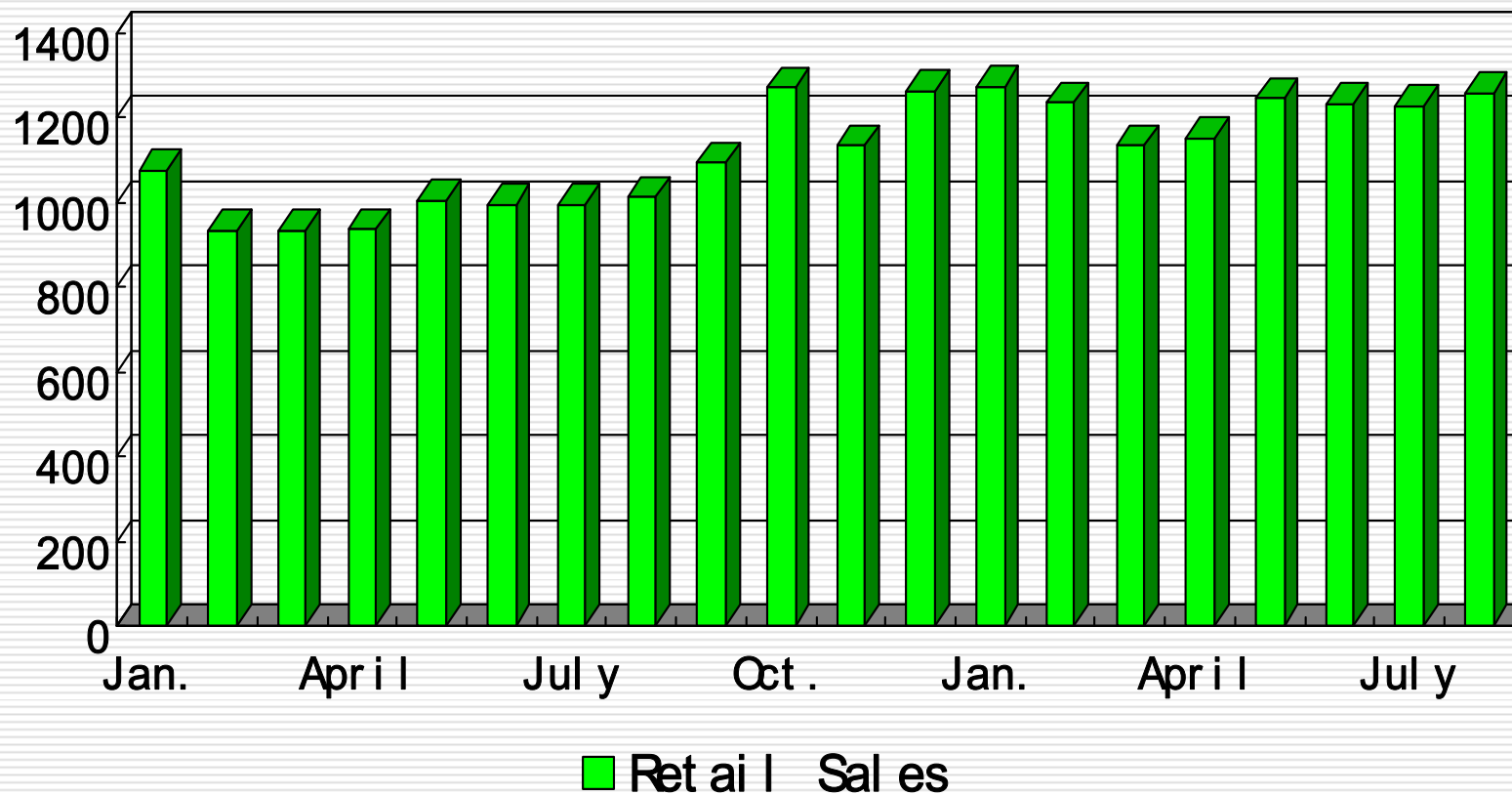
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- ❑ Urban disposable income officially grew by 9.3% in Q4, 2009.
- ❑ Retail sales performed remarkably well during the global economic slowdown, they grew 16.5% in 2009.
- ❑ Government subsidies have support retail sales.

# Retail Sales of Consumer Goods

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RMB billion



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- Computer sales seem quite strong, and home furnishings seem to be doing well too.
  - China became the largest producer and consumer of automobile in the world, surpassing that of the US in 2009: 13.6 million units.

## C. Investment

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- ❑ China's recovery in 2009 was government-sponsored and infrastructure-led.
- ❑ Fixed asset investment (FAI) grew by 35% in 2009 and 26% in Q1, 2010.
- ❑ Will this development model be changed or not?

## D. The Role of Capital Formation

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- What is the fundamental feature of China's economic growth?
- Three components of GDP by expenditure approach are final consumption expenditure, gross capital formation and net exports.

# Share and Contribution of the Three Components of GDP

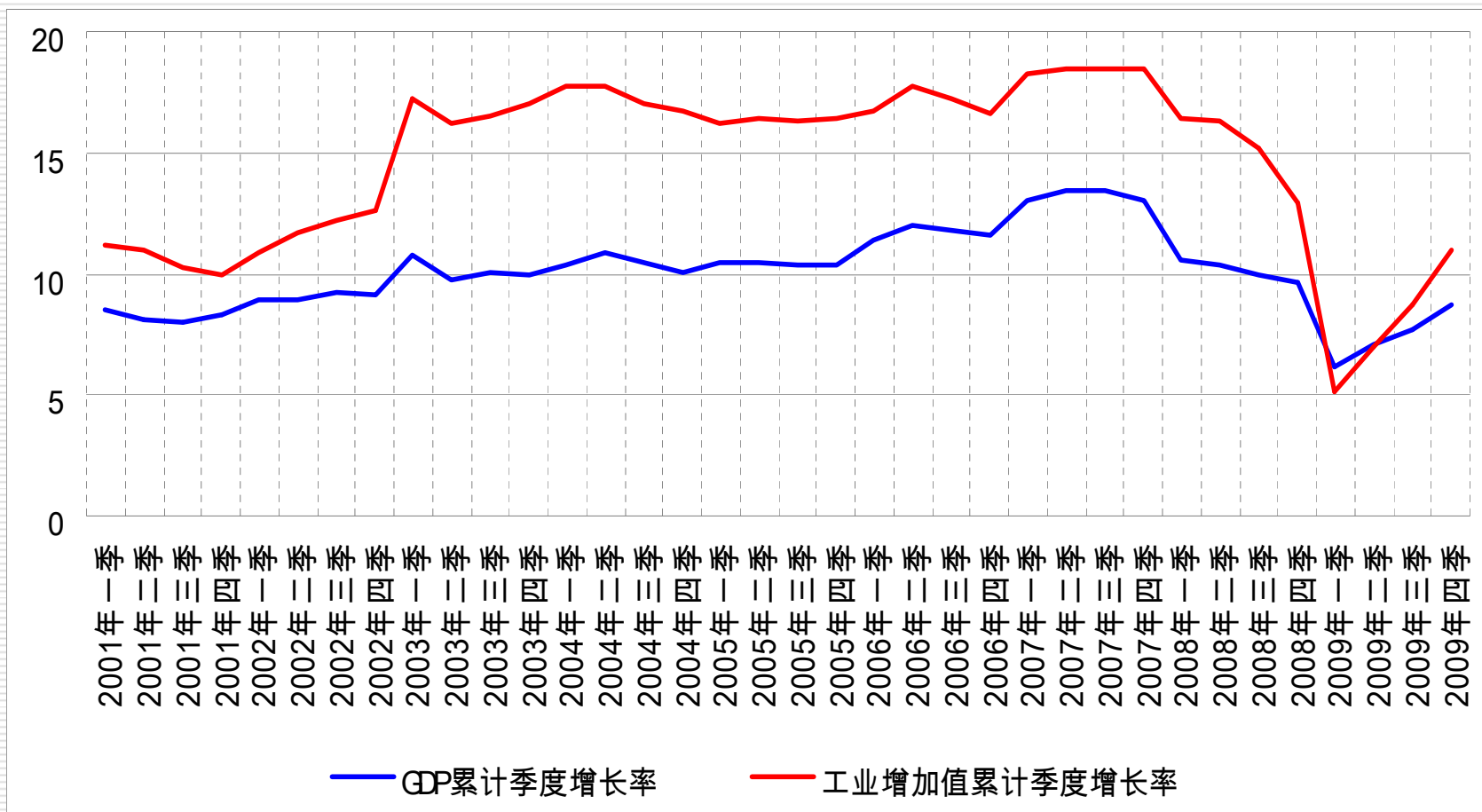
	Consumption		Capital Formation		Net Exports	
	①	②	①	②	①	②
2000	65.1	5.5	22.4	1.9	12.5	1.0
2003	35.3	3.5	63.7	6.4	1.0	0.1
2004	38.7	3.9	55.3	5.6	6.0	0.6
2005	38.2	4.0	37.7	3.9	24.1	2.5
2006	38.7	4.5	42.0	4.9	19.3	2.2
2007	40.6	5.3	39.7	5.1	19.7	2.6
2008	45.7	4.1	45.1	4.1	9.2	0.8
2009	52.5	4.5	92.3	8.0	-44.8	-3.8

## E. China's Driving Force: Industry

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- China's economic growth is very strong due to its industrialization.
- In year-on-year terms, Q1 and Q2-2010 growth look exceptional strong: 11.9% and 11.1%.

# GDP and Industry Growth



# China's Economic Data and Forecasts

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	2007	2008	2009	2010
GDP growth, %	13.0	9.6	9.1	10.5
CPI, %	4.8	5.9	-0.7	4.5
Current account, of GDP	11.3	9.6	5.8	5.2
Exports, USD billion	1219	1431	1202	1350
Imports, USD billion	956	1133	1006	1200

# Confidence on Economic Growth

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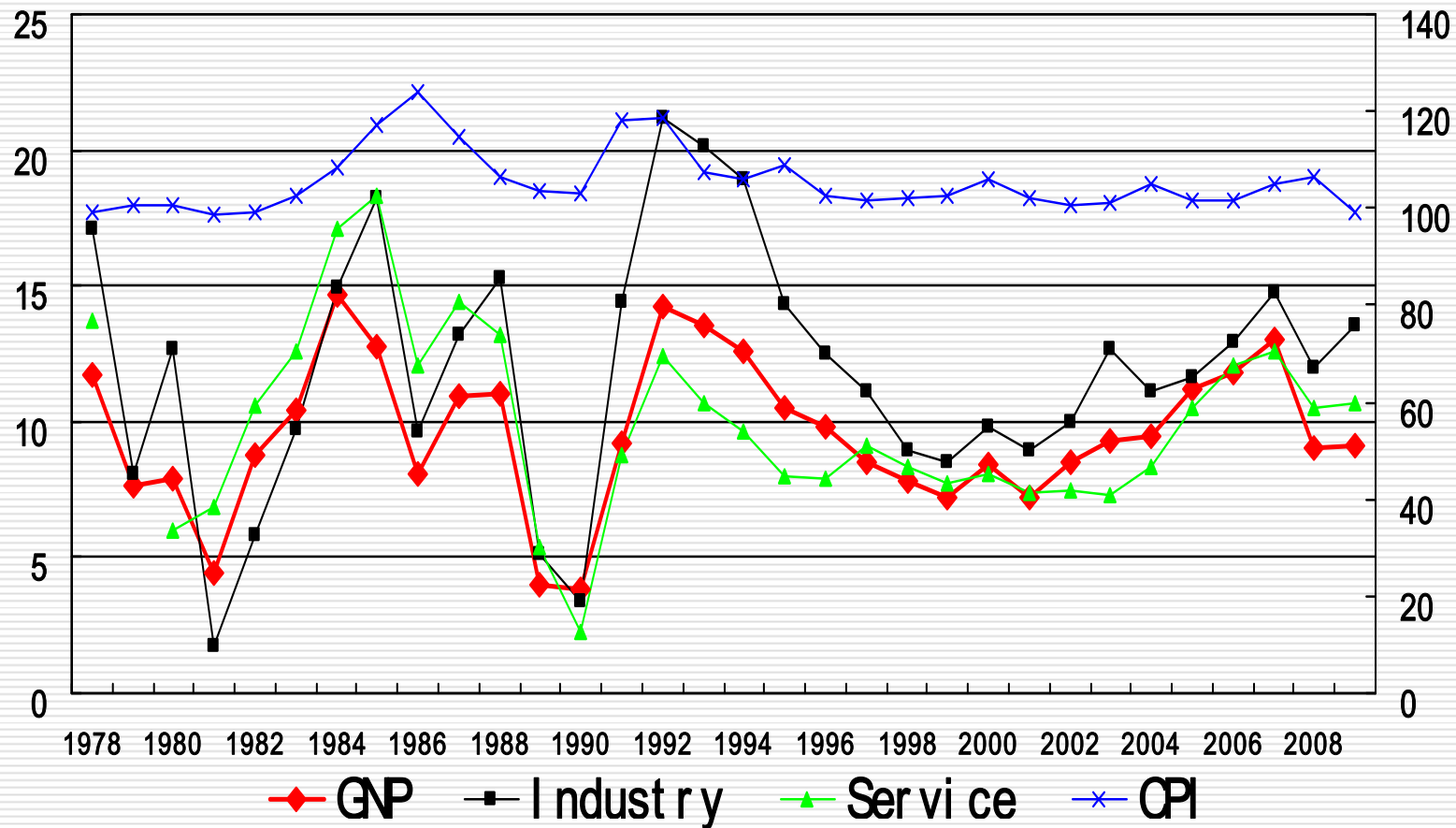
- ❑ Employment growth remains positive.
- ❑ Will strong sales and positive sentiment continue for the next quarters and years?
- ❑ China's economic growth has been based on the national industrialization.
- ❑ We need to discuss this unreversible trend of industrialization and its impact on global economy.

## 2. The Evolution of Industrial Structure

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- China is a developing country with huge population. Its GDP per capita in 2000 was only \$950 at official exchange rate, and increased to about **\$3500** in 2009.
- In the past three decades, market demand is the major driving force for structural changes.....

# Growth Rates of China's GNP, Industry, Service and CPI (1978-2009)



# Comments

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- ❑ Industry accounts for 43 percent of total GDP; and 91 percent of exports.
- ❑ The industry made a great contribution to China's economy progress.
- ❑ Is it sustainable for China's economy growth?
- ❑ Can the central government control the growth rate in development?

# Three Important Issues

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- A. Macro-management in economic development stability: growth-orientation policy.
- B. The success of export-orientation strategy or import liberalization strategy?
- C. Development target for labor-intensive or technology-intensive industries.

## A. Macro-management

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- Its GDP growth rate over 30 years is among the highest one on record.
- Although the pace of expansion was unusually rapid, inflationary pressure was largely absent in the most years.
- Industry has remained the leading sector since 1984. During the past two decades, industry has grown by above 12 percent per annum.

# Composition of GDP and Employment by Sectors in China

Year	Agriculture	Industry	Construction	Services
<u>Composition of GDP</u>				
1978	28.4	44.7	3.9	23.0
1990	27.1	37.0	4.6	31.3
2003	12.8	40.5	5.5	41.2
2008	11.3	42.9	5.7	40.1
<u>Composition of Employment</u>				
1978	70.7	15.4	2.2	11.7
1990	60.0	17.1	4.3	18.6
2003	49.1	16.1	5.5	29.3
2008	39.6	27.2	←	33.2

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- ❑ Industry is the largest sector in terms of GDP.
  - ❑ Unbalanced growth rates of different sectors: industry vs. service.
  - ❑ Aside from the economic development, the raising of people's standard of living should be the main way to expand the employment in services sector in the coming decades.

# Developing Economies

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- The role of agriculture to GDP has decreased from 27.1% in 1990 to 11.3% in 2008.
- However, the rural labor force still accounts for 39.6% of the national employment, by decreasing about 30 percentage points in the past 30 years, and will further to reduce under a new urbanization policy.

## B. Trade Liberalization

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- China's sudden rise as a global trading power has been greeted with a curious mixture of both admiration and fear.
- As an open economy and a large importing country, China has opened its door for foreign firms to develop new markets for their goods and services, especially high-value-added products such as aircraft, software, industrial design, advanced machinery, and components such as semiconductors and integrated circuits.

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- China turns into the largest exporter in the last year, which is unanticipated by international observers.
  - What is a real effect on the global pattern? What can we learn from the past experience?

# The Timetable of Trade Liberalizations

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Tariff	1982	1991	1998	2005	2007
Categories	17	21	21	22	
Maximum	104.9%	90.8%	28.7%		
Average	55.6%	44.1%	17.1%	9.4%	5.4%

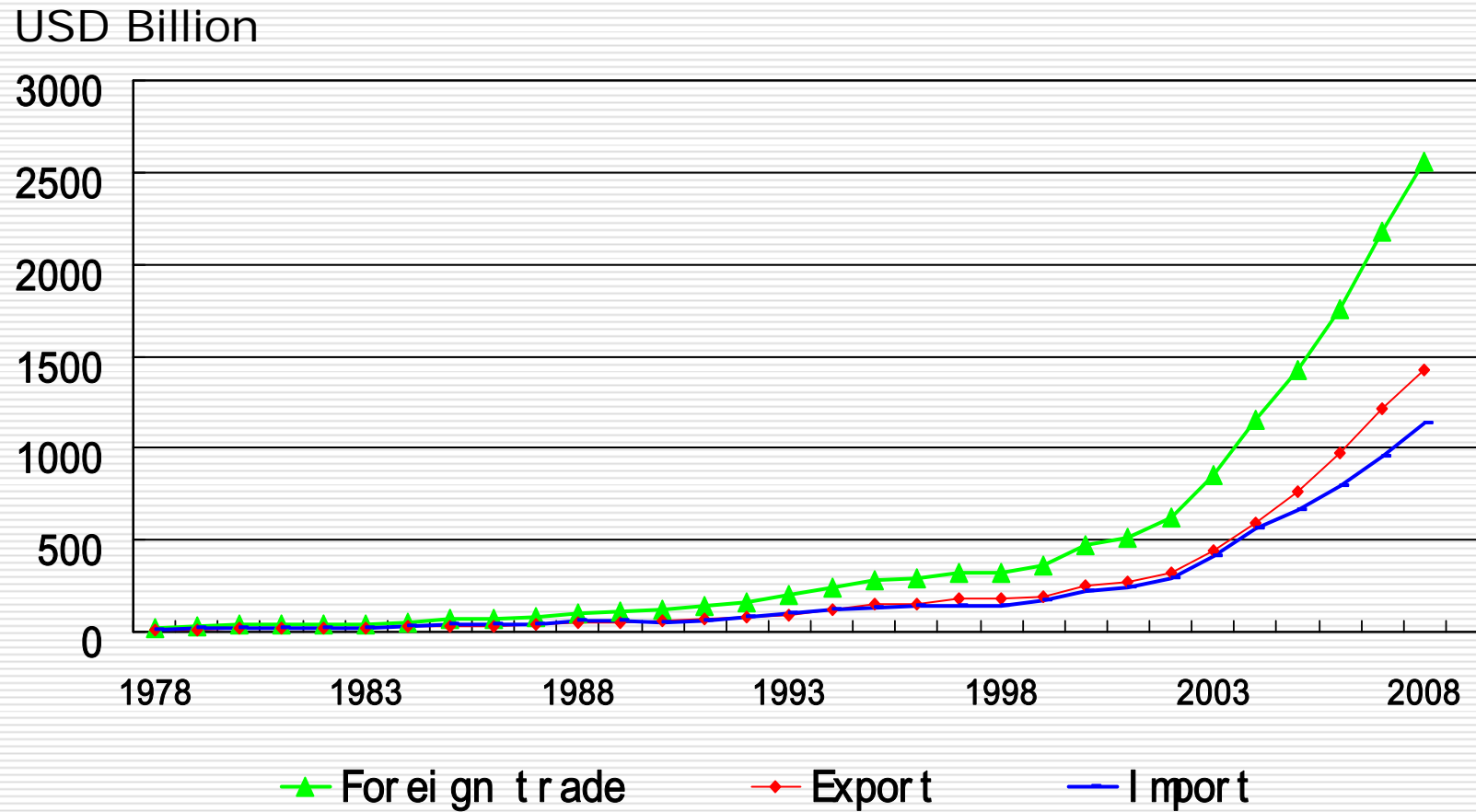
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- China's trade liberalization was part of a wider strategy of achieving stability and efficient resource allocation in the past 30 years, especially in the last 15 years.
  - The pursuit of a policy of industrialization took a gradual liberalization in tariffs and import quota controls as a means of integrating into the world economy. China's import/GDP ratio back in 1978 was 5.17 percent. Since 1978 or so, the figure has been in excess of 35 percent (in 2007).
  - Trade has been substantially liberalized in the 1990s. The average tariff has been brought down from 55.6 percent in 1982 to 44.1 percent in 1991, and further to 13 percent for industrial products in 2001.

# Dancing with Wolves

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- The import tariffs on various categories has been decreased in the China's entry of WTO, such as the tariffs on vehicles and its parts had been reduced to 25% and 10% respectively by 2005.
- After joining the WTO, China decreased the tariffs on IT products to zero.

# External Trade Performance in China (1978-2008)



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- From 1992 to 2000, China's trade grew by 12 percent per annum, since overall growth in GDP was about 9 percent per year, this implies that trade became substantially more important to the Chinese economy.
  - During the period 2002-2008, China's exports grew by about 20 percent, while economic growth was 12 percent per annum.

# Different Views

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- A close look at the breakdown of China's economic rise in perspective. Foreign-funded enterprises accounted for 55 percent of China's exports last year. In this respect, China diverges from the typical Asian success story.

—George F. Gilboy.

The Myth Behind China's Miracle

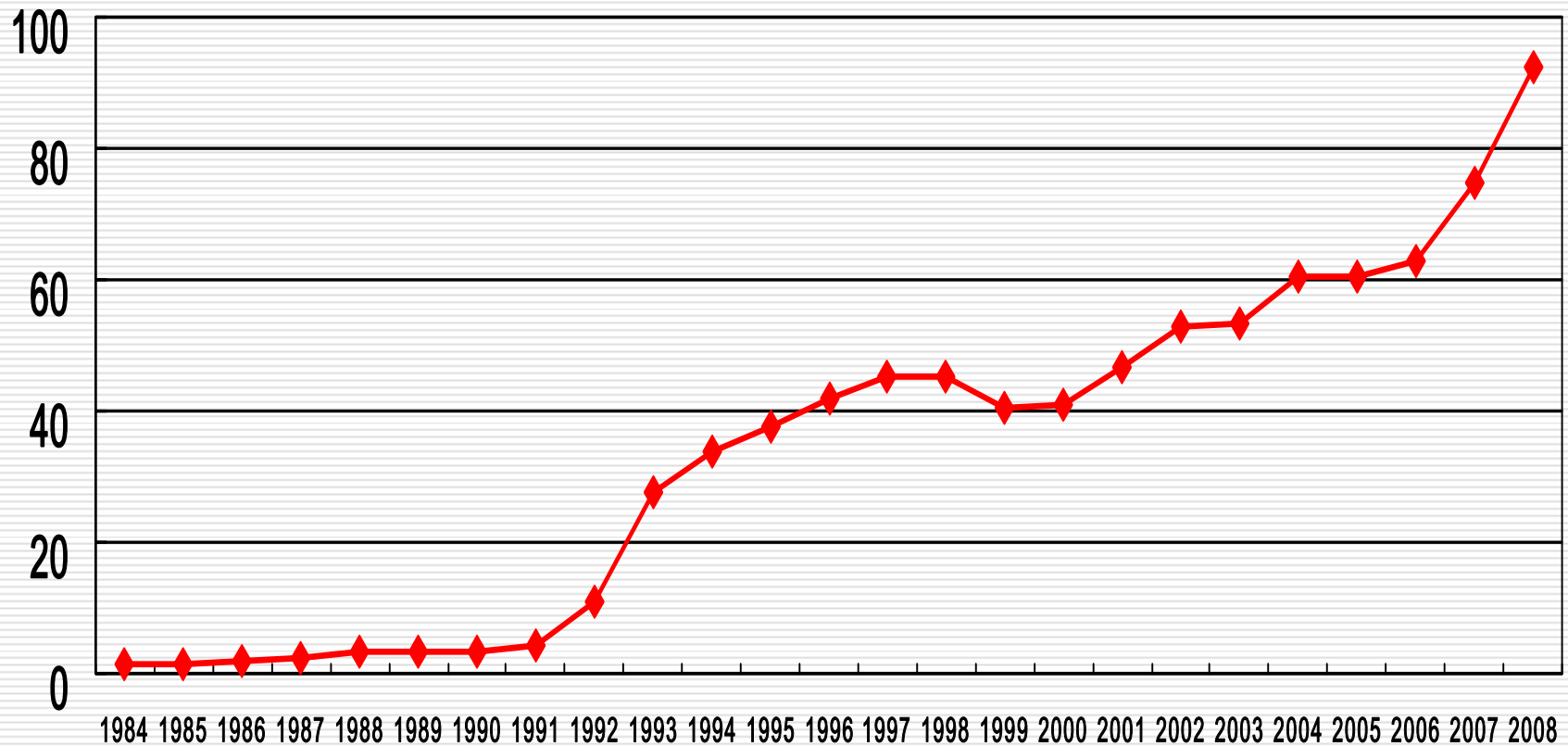
*Foreign Affairs*

July/August 2004, Volume 83, No.4

- Can we agree with this statement? If yes, what is our reason?, If not, how can we explain it?
- .....

# The Growth of Foreign Direct Investment in China (1984-2008)

USD Billion



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- Amid China's industrialization under the support of FDI, products are diversified, becoming more value-added, and technology-oriented so quickly that the composition as exports is about to undergo a major change as the share in world trade is significantly raised.
  - Major international makers of high-technology products are accelerating the shift of production to China since the second half of the 1990s.

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- The movements of foreign capital and technology into China are making China's industry towards the sophistication of structure and increasing technological competitiveness in the world market.
  - If the decline of FDI inflow into China, what will be happened to China's industry?

## C. The Change of Export Competitiveness

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- The share of manufactured products increased from 37% of merchandise exports in 1985 to 91% in 2002.
- The composition of exports shifted toward capital goods, which are usually more technology intensive than light manufactures such as textiles, food processing and garments.

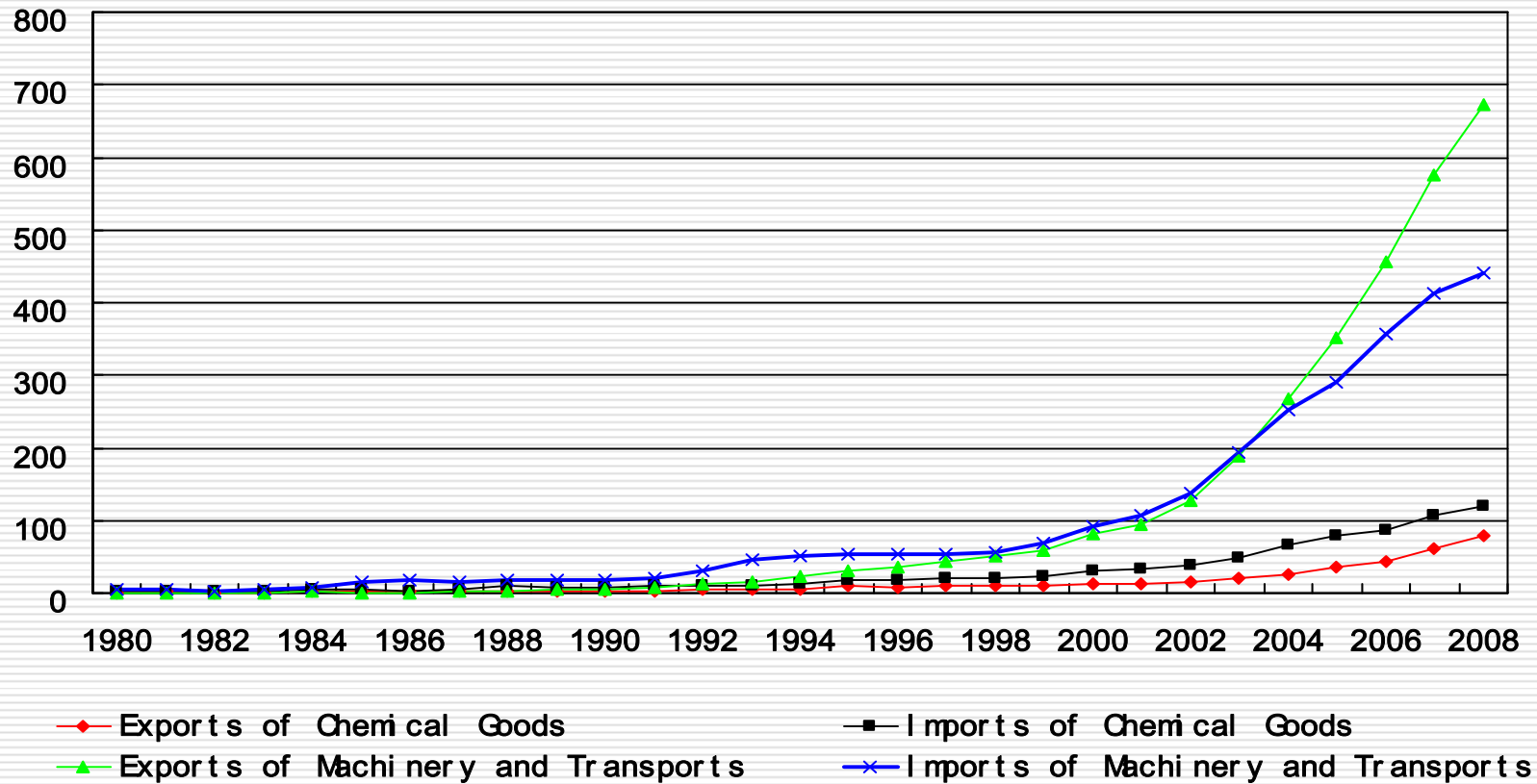
# Different Stories

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- The implications of China's entry into the WTO suggest that China can benefit from the expansion of labor-intensive industries such as textiles and garments, in which its global market share is expected to increase significantly.
- The export of textiles increased from \$49.83 billion in 2000 to \$165.80 billion in 2007, increasing by 3.3 times; however, the export of machinery and electronic goods increased by nearly 6 times, from \$82.60 billion to \$698.61 billion, at the same period.

# Trade in Major Products

USD billion



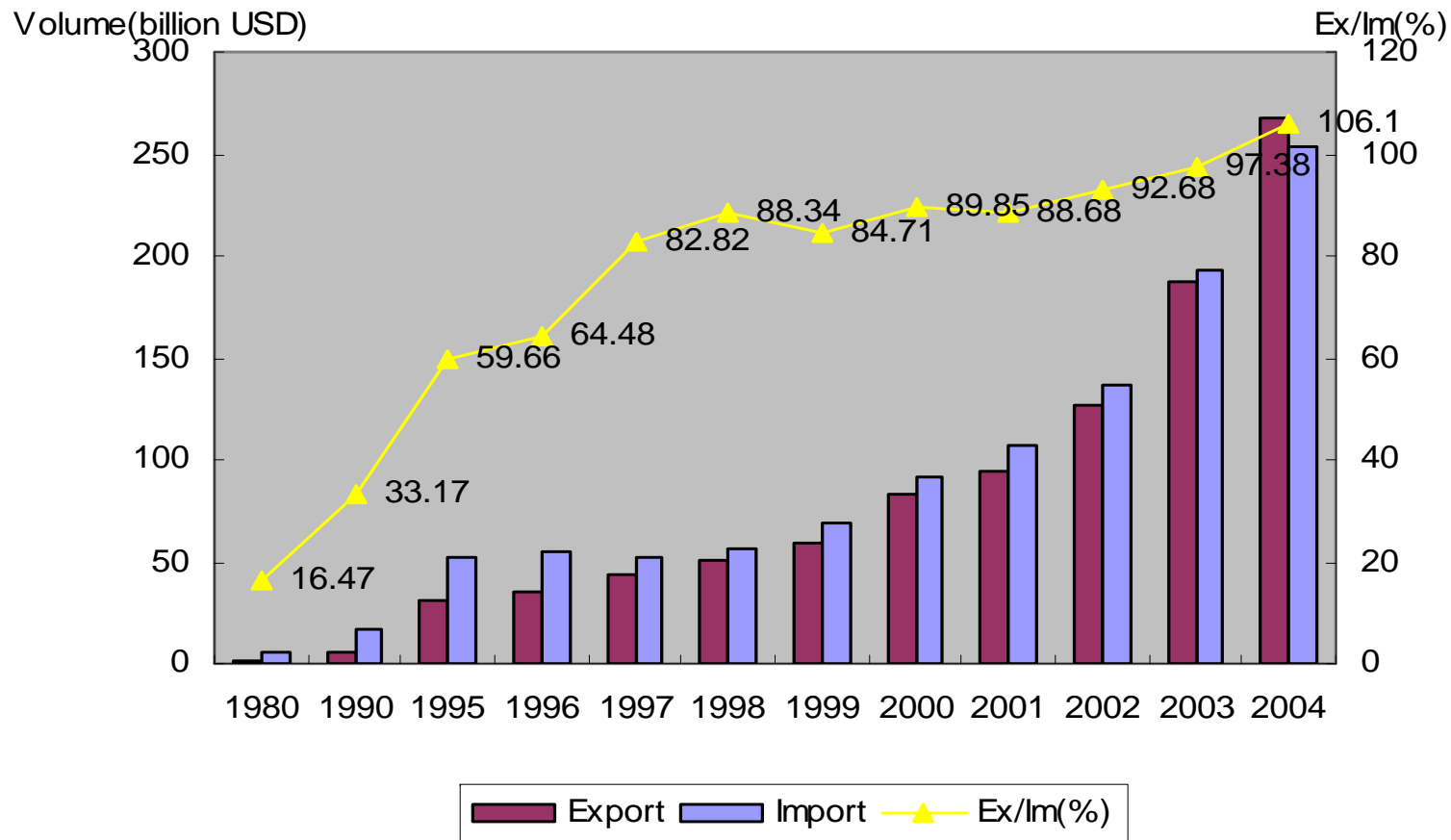
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- In 2002, the ranking of machinery and electronic products grew to the top with **\$126.98 billion**, higher than that of miscellaneous products with \$101.15 billion.
  - In 2007, the machinery and electronics accounted for 49.78 percent of the total manufacturing exports.
  - Learning through importing and exporting activities in China's technological industries.....

# A Learning Effect

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- Through the “use” of imported technologies, China can acquire some comparative advantages in low-tech mature products and related industries.
- Learning effects in trade of manufacturing products: the case of machinery industry.

# Changes of Machinery & Electronics Trade Structure



# Technology Deepening

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- The ratio of export of machinery and electronic goods to its import was 36.48 percent in 1991, and changed into 97.38 percent in 2003, and further into 139.9 percent in 2007.
- The contribution of imported technology to industrial restructuring has been significant.

# 3. Industrial Restructuring

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- ❑ It is major task for Chinese economies to expand its manufacturing capacity, especially in technological industry.
- ❑ How to assess the technological levels for Chinese economies?
- ❑ Which direction for China's industrial restructuring has been taken?

## A. Big Changes of China's Manufacturing Industry

	Textile & Garments		Machinery & Electronic	
	Output	Share of M. (%)	Output	Share of M. (%)
1992	358.07	14.42	565.36	26.43
2004	1322.66	8.10	5883.99	36.05
2007	2633.37	7.45	13515.29	38.22
2008	3082.88	6.98	16695.00	37.83

Unit: RMB Billion.

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- Will China keep its labor intensive industries for many years? If yes, how long?
  - Industrialization remains the largest driving force for China. Industrial production growth is running at a multi-year high of 20%.

## B. Growth of Labor Productivity

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- ❑ Explanation on productivity.....
- ❑ The rising of industrial competitiveness is strongly related with the growth of labor productivity in manufacturing sector.
- ❑ Different growth rates for industrial output and labor.....

# Growth of Labor and Output in Some Manufacturing Industries

Industry or Products	1995	2000	2007
Textile labor, '0000 persons	673.00	327.00	626.26
Yarn (10,000 tons)	542.20	657.00	2068.17
Apparel labor, '0000 persons	175.00	120.00	414.19
Steel industry labor, '0000 persons	346.00	222.00	304.43
Rolled steel (10,000 tons)	8979.80	13146	56561
Transportation equipment industry	370.00	244.00	408.59
Passenger cars	33.70	60.70	479.78
Electronics& Telecommunication	172.00	138.00	587.92
Integrated circuit (trillion units)	5.517	5.880	41.12
Micro-computer (10,000 sets)	83.57	672.00	12073.38
General machinery labor, '0000 persons	405.00	222.00	420.71
Metal-cutting machine tool (10,000 units)	20.34	17.66	64.7
Manufacturing labor, '0000 persons	5439.00	3240.00	7875.20

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- Industrial products increased more rapidly than labor force in all manufacturing industries over the surveyed period.
  - Discussion on industrial competitiveness in international perspectives.

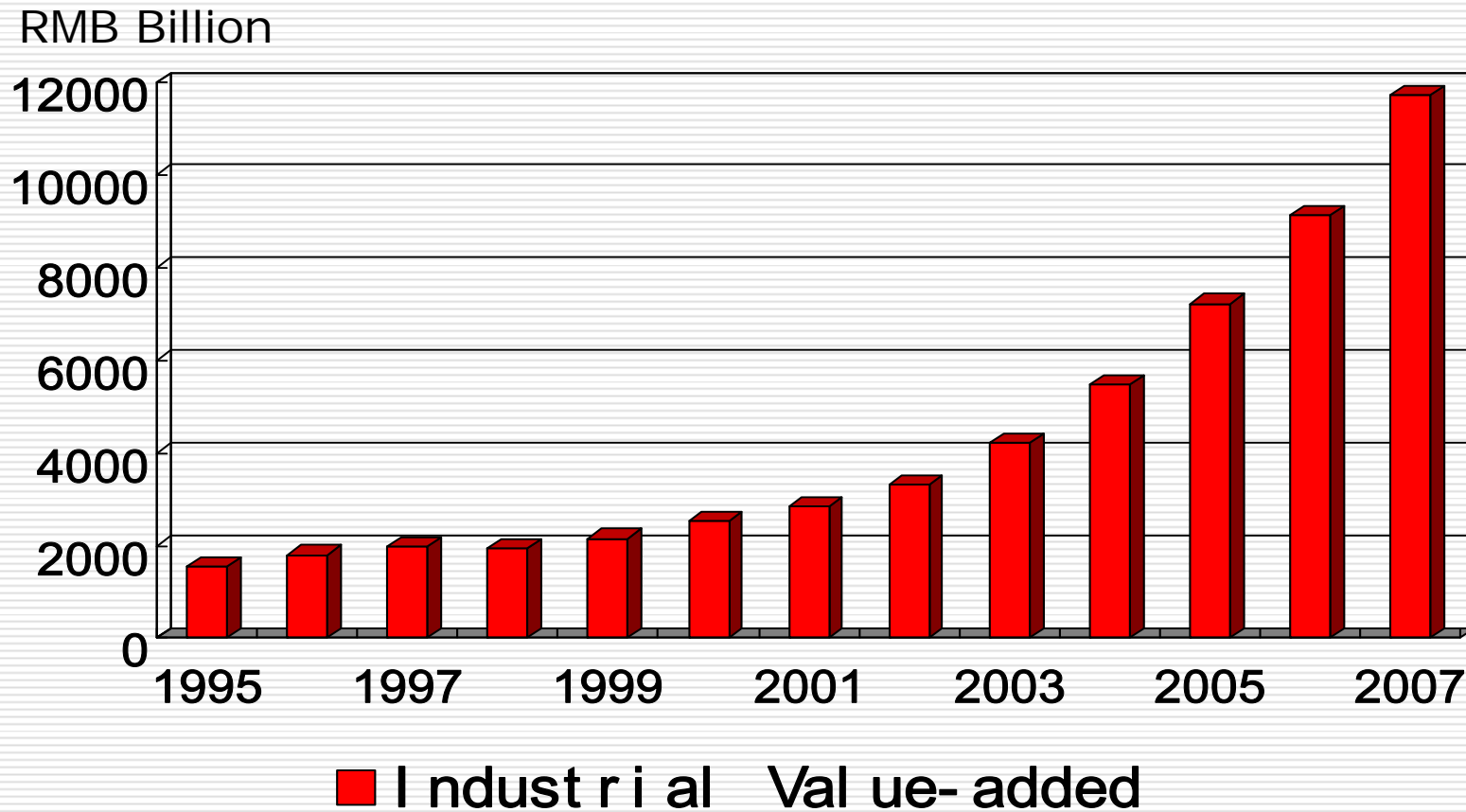
## C. Industrial Revolution

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- Industry has been the most important driver for China's economic growth.
- The higher growth rate of manufacturing industry, the higher of GDP growth rate emerges in China's industrializing process.

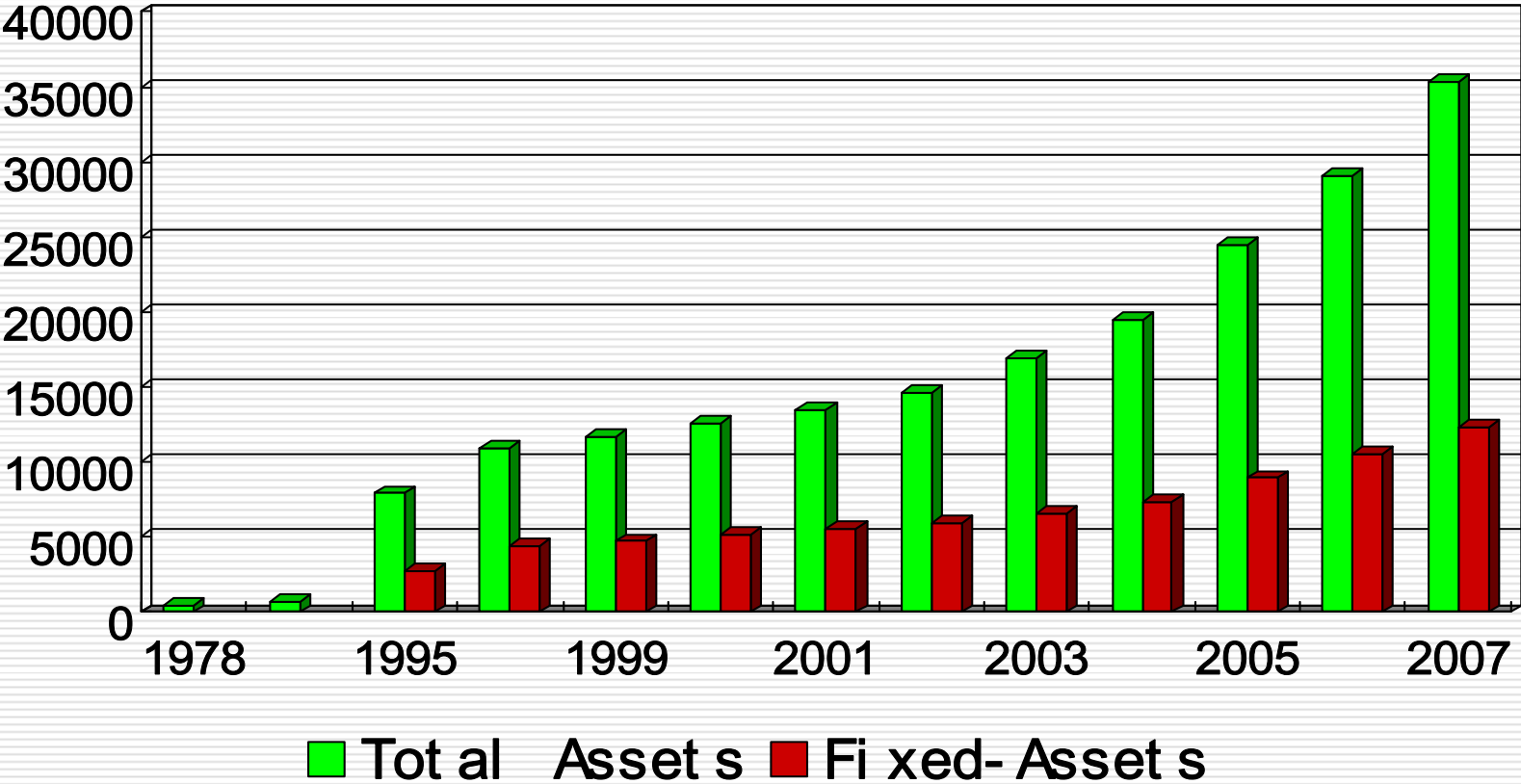
# Growth of Industrial Value-added

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# Growth of Industrial Assets

RMB billion



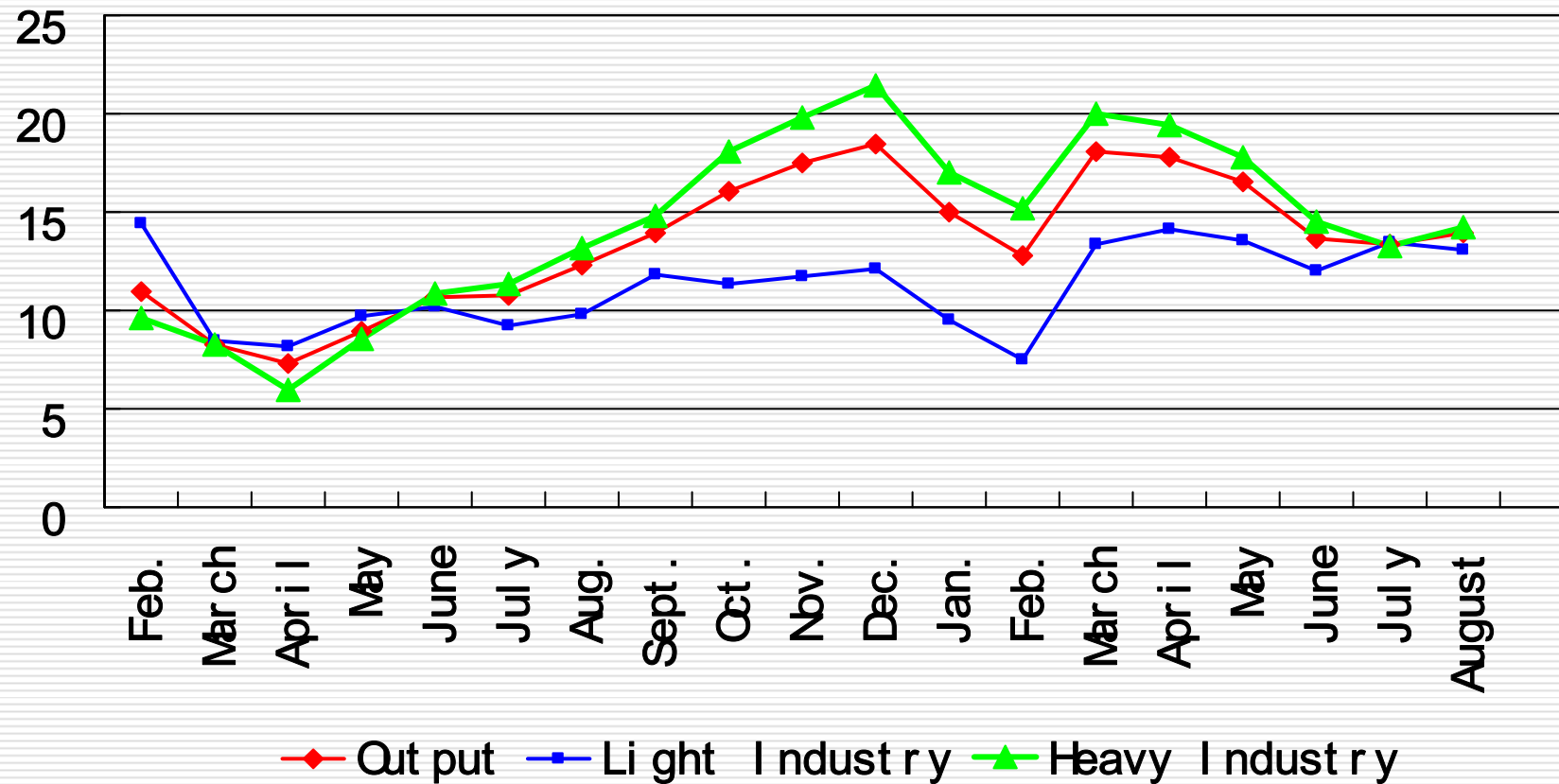
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- The growth rate of industrial assets has been lower than that of industrial output. The growth of industrial assets was not as high as expected in comparison to industrial output.
  - More fixed-asset investments have been flowed into steel production, machinery, electronics, and transportation equipment industries.

## D. Business Cycle and Industrial Growth

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- Will Chinese economy be recovery through traditional industrialization during the global downturn caused by the US financial crisis?
- New trend of China's industrialization: industry and regional factors.

# Different Growth Rates



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- ❑ The sharp declines in growth rates emerged in export-oriented as well as labor intensive industries.
  - ❑ Double-digit growth rates for China's heavy industries happened again in the past ten months.
  - ❑ It's the time to revive the heavy-industry-oriented strategy in China.

# Slow Growth of Export-Oriented Output, %

Industry	October	First 10 months
Textile	11.1	7.9
Apparel	10.7	10.4
Leather goods	12.5	7.6
Furniture	13.1	7.8
Articles for education and sports	6.5	7.7
Metal products	14.0	8.6
IT products	7.2	2.5
Industry	16.1	9.4

# Strong Growth of Heavy Industries

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Industry	October	First 10 months
Chemical industry	25.4	11.9
Pharmaceutical goods	15.6	13.7
Ferrous metals	25.1	7.2
Non-ferrous metals	24.3	10.3
General purpose machinery	15.5	9.4
Special purpose machinery	11.8	11.6
Transportation equipments	28.9	15.2
Electric machinery	12.7	11.0
Industry	16.1	9.4

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- Different views on China's excess industrial capacity.....
  - If China's industrial growth will keep its dynamics in the coming five years, what implications for global rebalance?
  - China is transferring to be one of the major industrial economies, how long?

## 4. The Role of the State

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- ❑ A strategy of gradualist economic reform.
- ❑ Economic growth is the top priority of social life.
- ❑ Political slogan: Development is the only hard truth.

## A. Decentralization

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- ❑ Decentralization-centralization-decentralization with new features.
- ❑ The role of political hierarchy to economic development.
- ❑ Central-province-cities or prefectures-counties-towns.

# Hierarchical System

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Tier		Area, sq. km	Population
Mega-city	Beijing, Shanghai	3500~5000	20 million
Metropolis	30	2000	2-10 million
Prefecture level	300	500	1-3 million
County level	2000	100	0.5 million
Towns	36000	5-25	50,000

## B. Progressive Marketization

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- ❑ Liberalization of economic activity such as trade, free firm system.....
- ❑ To lower the barriers to business entry.
- ❑ Transition overall was an interactive process involving top-down policymaking and bottom-up response and innovation.

# Market Competition

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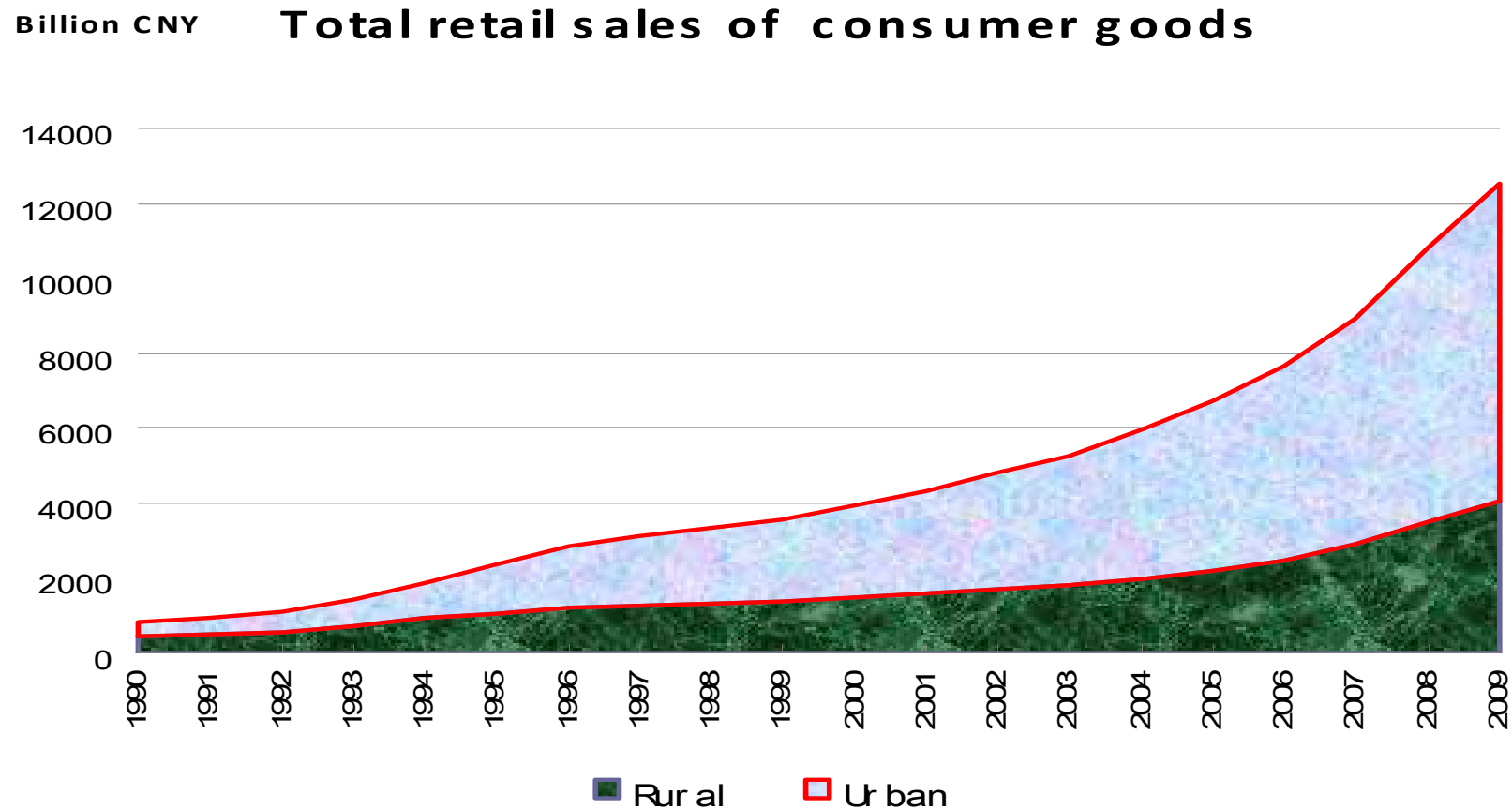
- ❑ Privatization of state-owned SMEs and TVEs.
- ❑ Selective withdrawing of the state monopoly over economic activity.
- ❑ New policies lowered barriers to migration to the cities and abolished the guaranteed employment of public enterprise workers.

## C. Urbanization-Oriented Policy

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- ❑ The year of watershed: 50% vs. 50% in the consumption between urban and rural areas in 1993.
- ❑ 67.92% vs. 32.08% in 2009.
- ❑ Household income increased ten times, and 6.5 times for rural household during last two decades.

# Less Population, More Consumption



## D. Towards A Regulatory State

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- ❑ Overall, china is still far from a highly functioning well-regulated market economy.
- ❑ The objective of a well-regulated competitive market is proposed, and will be achieved through more reform policies and measures.....

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□ Thank You!