1. Rebalancing Chinese Economy

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Outline

1.1 Background of Chinese Economic Development

1.2 Driving Forces for Chinese Economic Development
   • Export-oriented Economic Growth
   • Investment-driven Economic Growth

1.3 Unsustainable Economic Growth
   • Weak Export Performance
   • Overcapacity in Industrial Sector
   • Imbalance Regional Economic Development

1.4 Chinese Government’s Measures to Rebalance Chinese Economy
1.1 Background of Chinese Economic Development
Economic Reform

In the past 40 years, China has undergone the economic reform – a transition from planned economy to market economy – which resulted in rapid economic growth.

• The household contract responsibility system
• The reform of state-owned enterprises (SOE)
• The establishment of Special Economic Zones (SEZ)
Economic Reform

• The FDI brought both capital and technology to China, which supported the Chinese economic growth.

• Due to low cost of production and preferential government policies, China has become the “World Factory.”

• Later in 2002, China joined the World Trade Organization (WTO), which further opened up the Chinese economy.
Trade of China

Source: World Bank
MC Q1

1. What does the above graph show?
2. During the financial crisis in 2008 and 2009, how were exports and imports affected?
3. What is the general trend of exports and imports from 2000 to 2015?
4. What does the Balance of Trade represent?
5. What can be deduced from the graph regarding China’s Balance of Trade?
Economic Slowdown

The GDP growth rate has decreased since 2007 and has continued to follow the downward trend till this day. There are three main reasons to the slowing economic growth experienced by China.

• The primary benefits brought from the economic reform have almost been exploited.

• Since China joined the WTO, the Chinese economy has become more relied on the exports. Thus it has become vulnerable to fluctuations in the global economy.

• The investment-driven growth model is not sustainable in the long run. The rapid economic development in China also led to other problems, including income inequality.
China’s Real GDP Growth Rate in 2000-2015

Source: World Bank
**MC Q2**

1. During which year did the GDP growth rate peaked?
2. During which year did China record its lowest GDP growth rate?
3. China’s Real GDP growth rate has been growing since 2001 and has been following a(n) ___________ trend till 2007. However, due to the financial crisis, Real GDP growth rate has been ____________ in general.
4. From the graph what can you say about the Real GDP in China?
Exercise 1: Background of Chinese Economic Development

1. Benefits of Economic Growth
2. Costs of Economic Growth
1.2 Driving forces for Chinese Economic Development
Trade Performance

• Since joining the WTO in 2002, trade activity in China has increased immensely, with exports growing at a faster pace compared to imports leading to an increase in trade surplus.

• With its cost advantage, prices of Chinese-produced goods are significantly lower than that from most developed countries, leading to higher demand for Chinese goods overseas.
## Trade Performance

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China Exports as a % of GDP

Source: World Bank
Export-Oriented Economic Growth

The trade surplus has had a positive effect on China’s GDP.

• Just from 2002 to 2014, the trade surplus has grown by over 11 times, which also largely explained the rapid economic growth in China.

• Additionally, exports contribute roughly 25% of China’s GDP in 2014 and peaked at 35% in 2006.

NOTE: Recall that GDP = Consumption + Government Spending + Investment + Net Exports.
Investment-Driven Economic Growth

Investments by the government could lead to an economic growth in both short run and long run.

• In the short run, the government investment on infrastructure also creates demands in China. For example, the development of infrastructure leads to an increase in demand for raw materials such as steel and cement. The increased demand for production materials and machinery also encourage companies to invest into machinery to assist with their production. Hence the government investment can support the Chinese economic growth in short run.
Investment-Driven Economic Growth

Investments by the government could lead to an economic growth in both short run and long run.

• In the long run, improving infrastructures through investment, such as roads and railways, will enhance the connectivity among cities in China, and between China and other parts of the world, allowing for more efficient and cheaper means of transportation for goods or people. It will have a positive impact on the Chinese economy, as well as the living standards of people in the country.
Percentage Share of PRC's GDP (at market price)

Source: National Bureau of Statistics of China
Remarks: (1) Provisional figures by expenditure approach;
(2) Government Expenditure = Government Consumption Expenditure;
(3) Investment = Total Fixed Capital Formation + Change in Inventory
1.3 Unsustainable Economic Growth
Weak Export Performance

There are two major factors determining the exports from China to other countries.

• The first factor is the competitiveness of goods produced in China. It may depend on the price and quality of these goods.
• The second factor would be the performance of external economies.
Increased production costs directly affect the price of goods produced.

• If the production costs increases in China, the goods produced would be charged a higher price in order to compensate the increased costs faced by the manufacturers.

• The increased price causes demand to drop domestically and internationally, causing a reduction in exports.
Weak Export Performance

One of the main reasons for the increase in production costs in China is the increasing labour costs.

- According to a report by Boston Consulting Group (BCG), it was found that the wage gap between China and the US workers has been gradually shrinking for the past few years.
Weak Export Performance

• There are also other factors affecting the cost of production in China, such as increase in minimum wage as well as tightening environmental regulations. These policies lead to higher cost of productions in order to comply with these policies.
Weak Export Performance

Furthermore, due to the increase in production costs in China, multinational companies may relocate their manufacturing sites to other countries, such as Vietnam, Laos and Cambodia, where production costs are lower. This reduces the amount of goods produced in China, which may further affect Chinese exports.
Exports by China compared to the Performance of the Global Economy

Source: World Bank
Weak Export Performance

It is noted that exports by China and the world GDP move in similar directions. If the global economy performs well, China exports more. In 2008, during the financial crisis, both the world GDP and exports by China decreased significantly. It shows that exports by China are vulnerable to economic fluctuation in the global economy.
MC Q3

1. What does the bar chart show in the graph?
2. What does the line show in the graph?
3. How do the 2 graphs (the line and the bar chart) interact?
Overcapacity in Industrial Sector

One of the more obvious side effects of using the investment-driven growth model is the increase in both government and private debts. Another side effect would be the overcapacity in industrial sector.
Overcapacity in Industrial Sector

• In order to finance investments in infrastructure and industrial sectors, the Chinese government needs to increase borrowing.

• To alleviate the negative impacts from the global financial crisis in 2008, the Chinese government launched a large scaled stimulus package, which consisted of investment totaling RMB 4 trillion, in an attempt to stabilize the economy at that time.
Overcapacity in Industrial Sector

In 2015, the government debt to GDP in China reached 38.6%. The ratio is considered to underestimate the Chinese government debt, as the off-budget liabilities borrowed by local government and debts of policy banks and state-owned enterprises are not included.
Exercise 2: Overcapacity in Industrial Sector
Imbalance Regional Economic Development

In the early stage of the economic reform in China, the Chinese government had preferential policies, including establishing SEZs, to support the economic development in eastern part of China. This partly led to the imbalance economic development among Chinese provinces.
In terms of GDP per capita, the top three regions in 2014 were Tianjin, Beijing and Shanghai, which are located in the eastern part of China. The bottom three regions, namely Gansu, Guizhou and Yunnan, were located in the western part of China. The difference in GDP per capita between the two groups was almost three times.
Exercise 3: Imbalance Regional Economic Development
1.4 Chinese Government’s Measures to Rebalance Chinese Economy
Measures to Rebalance Chinese Economy

The Chinese government identified three major strategies to rebalance the Chinese economy. The three measures are: stimulating domestic demands, transitioning from low-level manufacturing sector to technology-based industry and service sector, and promoting outward investment on infra-structure projects overseas.
Stimulation of Domestic Demand

• The stimulation of domestic demand aims to change the Chinese economy from the one aimed at encouraging investments to one where demand and domestic consumption plays a more important role to the Chinese economic growth.

• Through the encouragement of domestic demand, it will resolve the overcapacity issue by balancing out demand and supply of domestic goods and addressing the issue of excess capacity.
Stimulation of Domestic Demand

Urbanization is considered as a method to stimulate domestic demand in China.

• Due to the higher income and living standards at urban cities, more people move to these cities and by doing so increases the general demand, for daily necessities such as housing, and general goods and services.

• Investments will also increase as the population in urban cities increase.
MC Q4
MC Q4

1. What kind of Income does the graph represent?
2. What does Per-capita disposable income mean?
3. How has the per-capita disposable income changed in general over the years?
4. What does the graph tell you about the disposable income in China?
Stimulation of Domestic Demand

On the other hand, promoting e-commerce is another way to stimulate the domestic demand.

In the past two years, there has been an uprising in e-commerce and online shopping in China. Several platforms in China have been very popular, namely Taobao and Alibaba, which has made domestic online shopping a lot more efficient and convenient hence leading to an increased spending.
Stimulation of Domestic Demand

• As a comparison, the sales revenue generated from China Singles day, 11 November, the sales on Alibaba reached 91.2bn yuan ($14.3bn), a 60% increase from last year.
Stimulation of Domestic Demand

- The government also encouraged the integration of e-commerce into other sectors of the economy and, in its 12th five year plan, stated that the government will implement policies to enhance this integration (also known as 互聯網＋). It may make consumption of goods more convenient and efficient, thus having a positive effect on domestic demand.
Policy Supports to Technology and Service Sectors

• The Chinese government stated, in the 12th Five-year Plan, that it aimed to develop several technology industries, namely new auto energy, energy-saving, environmental protection, new generation information technology, biology, high-end equipment manufacturing, new energy and new material.

• In 2010, these sectors contribute about 2% of the country’s GDP and the plan was to increase the share to 15% in 2020.
Contribution to GDP for different sectors

Policy Supports to Technology and Service Sectors

• The service sector has been developing since the 1990s, from contributing about 30% of China’s GDP in 1990 to close to 50% in 2014.

• The government has also imposed policies such as reducing taxes for some services such as education and medical services to encourage expansion as well as forming agreements with other regions, for example the Closer Economics Partnership Agreement (CEPA) with Hong Kong, supporting the development of trades in services from China.
Belt Road Initiative

China established the Asian Infrastructure Investment Bank (AIIB), which promote regional financial cooperation of Asian infrastructure projects such as railways, telecommunications, etc., within the Asia region. On the other hand, the Chinese government also launched the One-Belt One-Road Initiative, which also include a number of infrastructure projects in the OBOR countries