China's New Model of Economic Growth: Progress and Global Implications

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Growth Periods in Reform Era

- Agricultural and rural reform and growth 1978–84
- Investment expansion while seeking ideological and political basis for comprehensive economic reform 1984–92
- Uninhibited market-oriented investment expansion 1992–1999
- Uninhibited state-connected investment expansion 2000–2011
- New era of economic growth 2011--?

New model's objectives:

- Reduce external imbalance
- Increase consumption share
- Increase services share of consumption
- Reverse widening inequality
- Reverse global and local environmental degradation

Mechanisms of new model:

- Lewisian Turning Point (natural economic processes)
- Lowers profit share and savings share and possibly investment share and raises consumption share
- Therefore reduces energy intensity (environmental impact) and inequality

Mechanisms of new model:

- Policy

- Budget (tax and transfers)
- Environmental constraints
- Labour market: higher minimum wages and support for collective bargaining
- Market-oriented reform (including financial sector) to reduce state-connected bias.

Progress: Payments imbalances

- Current account surplus down from 10% of GDP to 2-3 %
- Below traditional surplus countries (Germany) and no longer an issue

Progress: Macro aggregates

- Current account surplus fall mostly the result of increased investment not consumption

- Investment share highest ever in 2013
- Household savings up to compensate for small decline in profit share, so savings share down only a couple of percentage points
- Services share up steadily from 41% in 2006 to 45% in 2012

Progress: Inequality

- Urban relative to rural incomes down from 3.6 in 2007 (3.8 in 2004) to 3.3 in 2012
- Wages double digit growth since 2004; easing to just above 10% last year with slower growth
- Minimum wages rising faster than market wages
- Gini coefficient peaked in 2008 (0.491) and falling gradually since (0.473 in 2012)

Progress: Environmental outcomes

- Huge turnaround reduces rate of deterioration and promises more
- Beginnings of electricity transformation
- Supported by transport electrification
- Heavy controls on heavy industries like cement and steel

Progress: Energy transformation

- Double digit growth in electricity output and coal use reduced radically since 2011
- Energy and emissions intensity targets missed in 2011 but enforced heavily since then
- Rapid growth in hydro, wind, nuclear (in that order in contributions to electricity output) with growth fastest for solar from low but now significant base
- Odds favour coal use in electricity being lower in 2020 than 2013 (5% lower?)

Progress from natural economic processes and policy interventions not market-oriented reform

- Policy contributions from minimum wages, environmental interventions, budget transfers
- Minor financial sector reforms: watch this space

Growth lower despite rising investment

- Reversal of demographic dividend will eventually take 2 percentage points from growth
- Decline of investment share would eventually take away some growth
- Maintaining government objective of 7.5 percent (down from around 10 percent 2001-2011) requires some lift in total factor productivity
- Higher total factor productivity possible with rising wages but requires market-oriented reform
- High investment share is compensating for the reality of lower productivity growth

Chinese Total Factor Productivity growth appears to have stopped

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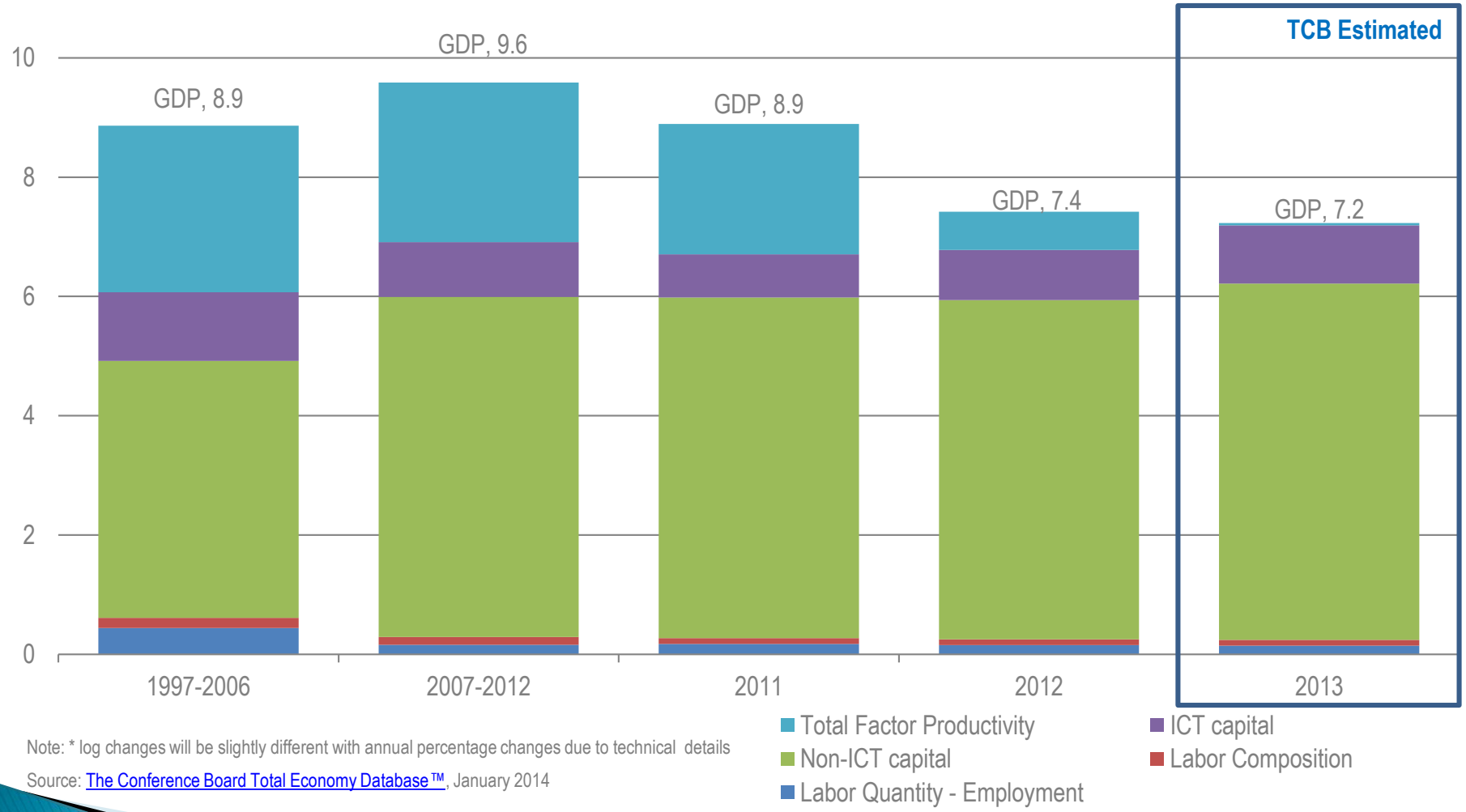

Note: * log changes will be slightly different with annual percentage changes due to technical details

Source: The Conference Board Total Economy Database™, January 2014

This pattern of growth is unsustainable

- Attempts to maintain it in old style introduces large risks
- Strong external sector gives China time
- Strong state makes hard reform possible
- But recognise the great challenge facing the new model of economic growth

Implications of success for the Global Economy

- Change in relative prices of goods and services, down for metals and energy (especially coal) and up for high-value foodstuffs, tradeable services
- Higher global real interest rates with any sustained recovery of investment in developed countries, slowing global growth
- But a hedge against weak recovery in the developed countries: China holding up global demand
- New model for low-carbon development, greatly lifting prospects for effective mitigation of climate change
- New model for development, and counterweight to extreme opposition to public sector role in externalities and public goods

Implications of failure for the Global Economy

- New global recessionary pressures
- Devastating for resource exporting countries
- Probably neutral for global climate change, as failure would not extend to back-tracking on energy transformation