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)
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

Growth rates (log changes*)

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