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China's Economic Performance

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Over the last three decades China has experienced enormous increases in its share of global output. Large-scale economic reforms, changing demographics, productivity growth and consistently high returns on investment, all contributed to the dramatic increase in China's share of output from two per cent globally in 1980 to 13½ per cent in 2010. Future prospects for continued Chinese growth look positive, but will depend on how China deals with internal issues. Australia's future is linked with China's because China is currently both Australia's largest import and export partner. In 2011-12, exports to China accounted for 27 per cent of the total value of Australia's exports of goods and services, while imports from China accounted for 18 per cent of the total value of Australia's imports of goods and services (DFAT, 2012).

The Chinese economy is complex in nature and economic analysis is hindered by a range of factors. For example, there are measurement issues relating to the integrity of economic data reported to Chinese government agencies (Hu & Khan, 1997). There have been both positive and negative aspects to China's high speed game of catch up, but overall living standards have, in terms of gross domestic product (GDP) per capita almost quadrupled compared with before reform averages (Chenggang, 2011, p. 1085). This essay will briefly examine the main factors which have driven the extraordinary growth of China's economy over the last three decades, the future potential of Chinese growth and the trade relationship Australia has with China.

Productivity Growth

The modernisation of China's previously closed economy saw planned markets and collectivisation abandoned as the CCP gradually allowed more foreign direct investment (FDI) and access to foreign markets. This introduced profit incentives for firms to compete for on a local and international level, and improved efficiency greatly. International integration moved the labour force into competitive high-productivity industries away from agriculture where labour was previously concentrated. New technologies and management techniques allowed

for the large increases in efficiency required to compete in the international market that Chinese enterprises now participate in actively (Guo, 2009, p. 113). Hu and Khan (1997) concluded in their report for the IMF that

sustained increase in productivity (that is, increased worker efficiency) was the driving force behind the economic boom.

Prior to 1978, total factor productivity (TFP) accounted for only 11 per cent of economic growth, and after the move to a mixed market economy, TFP accounted for more than 40 per cent of economic growth (Chenggang, 2011, p. 1077). China was previously dominated by State Owned Enterprises (SOE) and as late as 1996 more than a third operated at a loss (Rush, 2011, p. 31). These inefficiently managed firms lowered China’s potential production of goods and services. China’s successful move away from state-run firms demonstrates the importance of effectively organising China’s large labour force (Figures 1 and 2). Policy changes that encouraged investment from overseas also played a large role in developing domestic infrastructure and private capital (Hu & Khan, 1997).

Figure 1

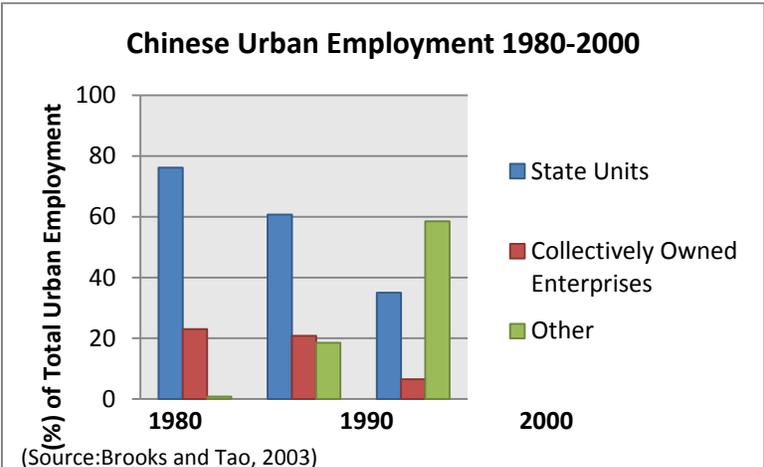
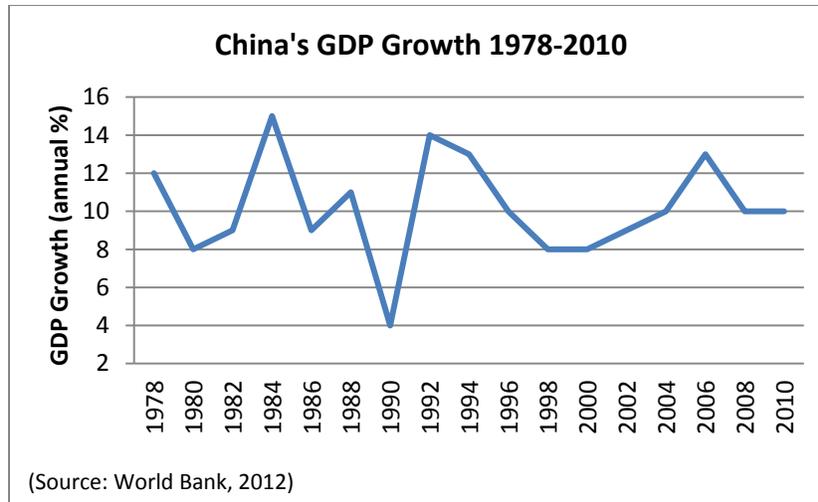


Figure 2



Investment and Capital Accumulation

Liberalisation of China's centralised economy allowed for greater unregulated trade with and investment from foreign countries. Before the 1980s, the central government controlled more than 90 per cent of international trade and monopolised imports and exports. Along with opening up competitive channels for domestic firms, access to both FDI and modern technology from outside of China (which access to had been previously restricted) both played an important role in capital accumulation, and in turn allowed China to reach higher productivity levels (Guo, 2009, p. 113; CIA, 2012). Institutional reforms designed to strengthen the foreign-related legal system helped to sure up the trading and investment environment. FDI before 1979 made up less than one per cent of total fixed investment, and rose to 18 per cent in 1994 (Hu & Khan, 1997). Over the last 30 years the rate of return on investment averaged above 20 per cent. The savings rate over the last 15 years ranged from only five per cent of GDP in 1992 up to an staggering 46 per cent in 2009 (Song, et al., 2011, p. 200). Such high savings was for a number of reasons outlined by Guo (2009) as

expected uncertainty, rising incomes, deflation, interest rates, the level of monetisation, capital market development and income inequality (p. 113).

Large domestic savings helped to keep the real interest rate (the interest rate adjusted for inflationary differences) from rising above 3.2 per cent on average, encouraging investment

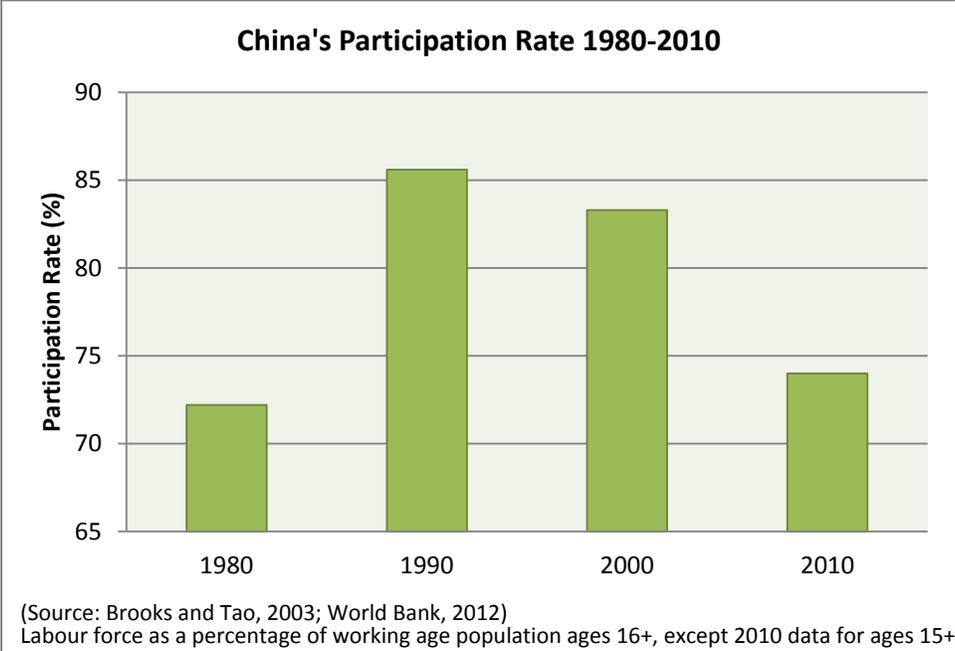
within China (The World Bank, 2012). However investment in capital stock can only be so beneficial for an economy, as by the law of decreasing marginal returns after a certain amount of capital is acquired adding more capital is no longer as beneficial. Chinese capital stock levels have increased dramatically over the past three decades, yet from 1979-94 the capital-output ratio has barely changed, indicating that most of the productivity growth has been due to increases in productivity and not solely capital accumulation (Hu & Khan, 1997).

Labour Force and Policy

The composition of the Chinese population and working force has changed both naturally over time and been influenced by domestic policy. Prior to large political reforms carried out by Deng Xiaoping in the 1980s and over the following three decades, the Chinese Communist Party's (CCP) focus has moved from class struggle to a growth-orientated outlook (Brown, 2011, p. 4). This shift of political aims may be seen as essential for the Chinese economy to open up and begin its journey to close the gap between standards of living in China and that of developed nations. Previously there had been two large-scale decentralisation schemes implemented in the 1950s and 1960s, the Great Leap Forward and the Cultural Revolution respectively. These caused great social and economic upheaval and adversely impacted on many Chinese people. The later reforms undertaken from 1978 onward were implemented more gradually across Special Economic Zones (SEZ), usually in coastal areas before further regional reforms were introduced (Guo, 2009, p. 133). Migration restrictions in place from 1953-78 restricted movements from the country to the city and the baby boom in the 1950s both helped to create surplus labour in rural areas by the 1980s (Figure 3). Before 1978, nearly four out of five Chinese worked in agriculture and by 1994 only one in two did (Rush, 2011, p. 33; Hu & Khan, 1997). The share of urban employment in 2009 was double that of 20 per cent in 1970 (Rush, 2011, p. 33). Movements within China were often influenced by work opportunities such as urban construction and manufacturing jobs which were concentrated in coastal areas. Economic development was accelerated in coastal provinces where market reforms were first experimented with, which created a disparity in wealth. 12 per cent of

Chinese rural labourers work away from home in coastal regions where wages are on average 15 per cent higher than inland wages. There has recently been a small decline in interstate movements within China as rising inland wages along with increased transport and living expenses associated with coastal living sees a move away from coastal migration to in-state migration (The Economist, 2012, p. 35). This trend could see a smaller discrepancy between coastal and inland living conditions which are currently markedly different. Education has also played a big role in improving the quality of human capital, increasing the skill and employability of workers.

Figure 3



Future Prospects for Chinese Growth

China faces many challenges associated with the welfare of its economy and in turn its people. Demographic factors will pressure the CCP to shift from export-led growth to reducing the high savings rate and increasing the correspondingly low domestic demand, whilst controlling inflationary worries (DFAT, 2012; CIA, 2012). Accompanying rising living standards is a

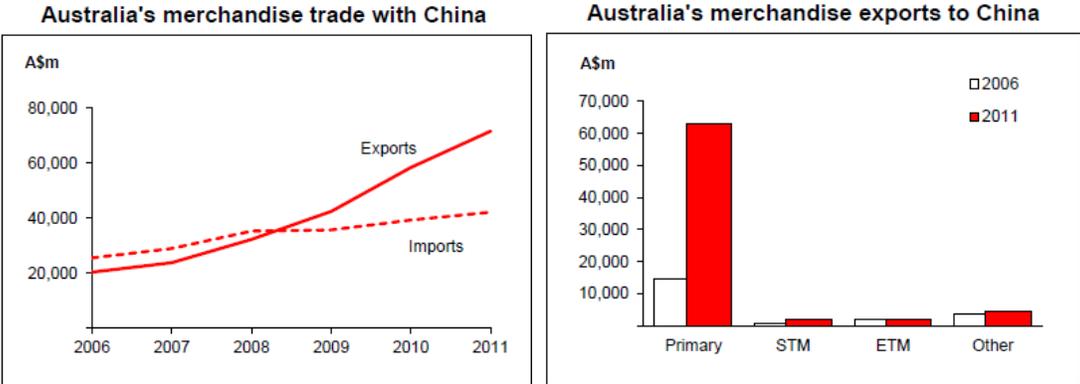
substantial increase in life expectancy of the Chinese people. The UN estimates that the working population is set to decline, and shrink by 20 per cent by 2050 (The Economist, 2012, p. 35). An ageing population will mean an increase in demand for health care and pensions and also a decrease in surplus labour that China has relied upon for its productivity boom. The current and future labour force will influence later productivity growth and help to determine China's capability to maintain high levels of growth. The One-Child Policy for example will have a significant impact on the future labour force as children traditionally support their parents when they are older, and doing this alone will quite possibly require deferring retirement. China has a very high Gini-coefficient of 0.5, a measure which is based on the Lorenz curve, 0 indicates income is distributed equally across the population and 1 indicates complete inequality. Most rural migrants do not have access to the same welfare benefits as urban citizens, and there is still a gap between the education levels of rural and urban workers that needs to be addressed (CIA, 2012; Rush, 2011, p. 33). China's high ranking on the corruption index and failure to provide access to basic benefits to the majority of its citizens can only pressure internal tensions which could undermine political stability, the basis of economic growth (Zhao, 2011, p. 13). The CCP currently spend 20 per cent of government funding on infrastructure, and while this may traditionally perceived as a socially beneficial investment, a recent study by Chen and Yang found that across Chinese provinces from 1978-2008 as infrastructure investment increased by one per cent, household consumption fell 0.3 per cent as a share of that provinces GDP. It might seem that China has surpassed the level of infrastructure that is beneficial and is now beginning to have a negative effect on consumption (Yang, 2011, p. 6). In 2001 China joined the World Trade Organisation which reassured observers that China was dedicated to continued market reforms and international integration. (Brown, 2011, p. 4).

Australia's Future with China

China is Australia's most important trade partner in both export and import markets, following a trend over the last five years of increasing trade. The largest imports China purchased from

Australia in 2011 were iron ore, coal and education-related travel; the majority of trade being made up of primary goods (see Figure 4). Main imports from China to Australia included elaborately transformed materials that Australia cannot produce competitively with China’s comparative advantage, such as telecom equipment, computers and clothing (DFAT, 2012). High Chinese demand for Australian resources have been in part down to our proximate location and abundance of natural resources. China’s growing energy demands assure Australian exporters of a reliable income. Demand for Australian education from Chinese students has steadily grown on average 18 per cent per year from 2005-2010. On the other hand, Australia has a less decisive impact upon the Chinese economy, but still provides 4.7 per cent of China’s imports (DFAT, 2012). China and Australia have been developing a free trade agreement (FTA) that will aim to remove or reduce trade and regulatory barriers, and to also encourage investment between China and Australia (DFAT, 2010). If such a FTA is established it will further increase trade between Australia and China. If China continues to gradually unpeg the Yuan from the US dollar, it will most likely appreciate and permit levels of domestic Chinese demand to increase, as the purchasing power of the Yuan rises. This would have a positive impact upon Australian exports as Chinese aggregate demand increases, but at the same time Australia’s reliance on Chinese imports would be tested as the price of Chinese-made goods increases.

Figure 4



(Source: DFAT, 2012)

Conclusion

The main forces that drive economic growth in China are interdependent and dynamic, and their interactions will determine the sustainability of China's future growth and in turn Australia's share in their economic success. Chinese production has increased enormously due to changes in productivity, investment opportunities, demographics and government policy. China is a leading example of an economy benefitting enormously due to increases in productivity levels. Without much disruption to its economy, China has managed to move the majority of its workers from agriculture into urban employment. If China manages to successfully implement further welfare aims after the CCP leadership change later this year, it may still be able to maintain its high share of global output and reach its goal of becoming a middle income society by 2020 (Brown, 2011, p. 5). Australia's economy is highly dependent upon China's, and as Chinese incomes rise along with demand for Australian exports, the links between our two countries will continue to be strengthened in the future.

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