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The Chinese economy: introduction

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China at the Crossroads

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China's at the crossroads, again. With the decennial transfer of political power comes uncertainty about the future direction of the country. This is always the case. What is different this time is that the last decade has been a period of economic growth in China which is perhaps unparalleled in human history, anywhere. But there is anxiety among the political elite and the increasingly prosperous middle classes about how sustainable the current path is. Growth has been slowing, albeit from a remarkably high rate, fuelling unrest among those afraid of losing their new-found gains. Inequality has been rising at an alarming rate. The 'have-nots' have begun to make their voices heard, both through social media and on the ground with industrial unrest a major problem for the regime, particularly in the interior. Some question whether the Chinese model of "socialist capitalism" is compatible with long-term growth, arguing that democracy is a pre-requisite for sustainable growth. Others think the current arrangements are more robust and that China's road to a market economy has been laid by sound political decision-making, especially at provincial, regional and city level where many of the policy experiments behind China's success have been devised, piloted and implemented. Seen in this light, some of the recent difficulties China has been facing, such as wage inflation, can be seen as part of the typical difficulties countries face as they transit towards a market economy. So now seems like a good time to take stock of where China is "at" by looking at some of the economic fundamentals. That is the purpose of this Special Issue on China.

The Issue begins with an article by Linda Yueh, Director of the China Growth Centre at the University of Oxford. She describes the difficulties analysts face in trying to account for China's phenomenal growth using standard growth models. The paper reviews the main modelling approaches to growth, reviews the existing literature on China's growth, and decomposes the factors behind China's growth into its various components. There are three issues that are salient. First, China is seemingly paradoxical in achieving such growth with what appear to be weak institutions. In fact, as the paper explains, China has engineered incentives for growth and productivity, albeit in an unorthodox fashion, which have delivered very substantial economic benefits. Second, China's impact on the global economy is so large that its development is hard to comprehend within the confines of models which have traditionally examined countries which are much smaller and, if larger, less open to the international economy. Analysts may do well to think in terms of what China is doing to the rest of the global economy, rather than begin with questions about the effect of the global economy on China. Third, questions are frequently raised about the sustainability of China's growth trajectory. The paper points to the importance of one-off hikes in productivity arising from various experiments China has undertaken with respect to capital restructuring and labour market reform. But these "one-off" episodes appear to happen quite regularly.

One crucial driver of China's economic growth has been the rise of its public listed corporations. Back in 2001 the public listed sector accounted for 14 per cent of China’s GDP. However, over the decade to 2010 the total output of the public listed sector increased eleven-fold such that, by 2010, it accounted for 43 per cent of China's GDP (Bryson et al., 2012). Today China's stock market capitalisation as a percentage of GDP is on a par with the United States and greater than that in the

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Euro Area and Japan. One way to assess China's role in the global economy is to examine the degree to which China's stock markets (Shanghai and Shenzhen) are integrated with those elsewhere. As Jan Babecky and co-authors explain in their paper dealing with this issue, the existing literature is large but evidence on integration is mixed. The authors have a lot of data to play with because, as they point out, although the total number of listed firms in China is smaller than the United States, Japan and the Euro Area, the total value of stock traded in China has surpassed that in the Eurozone and Japan. The authors consider stock price movements in China, Russia, the Euro Area, Japan and the United States. Overall they find increasing stock market integration after the 1997 Asian financial crisis and the 1998 Russian financial crisis. Since then the speed with which differences in individual stock market returns are eliminated after shocks (beta-convergence) has been fairly constant. This is true for China, the Euro Area, Japan, the United States and Russia. There has been no clear convergence, however, with respect to cross-sectional dispersion in the returns on individual stock markets at a given moment in time.

A perennial danger to growing economies is the threat of inflation. This is particularly relevant for developing countries like China where rapidly rising demand for goods and services has the potential to outstrip their supply, at least temporarily. This Special Issue contains two papers analysing inflationary pressures in China. The first, by Christian Dreger and Yanqun Zhang, is a very interesting investigation into the sources of pressure on consumer price inflation. The authors show that pre-Crisis inflation in China was driven entirely by international factors such as food and energy prices. But this changed with the Crisis: since then domestic factors such as nominal wages have become increasingly important. The paper points to important policy challenges ahead for China. Growth in domestic demand is a precondition for strong growth in the next Five Year Plan, and this in turn relies on growth in real wages. To avoid inflation, it is going to be necessary for productivity growth to match wage growth. Of course, as the authors note, tight trade linkages and the role of Chinese firms in international production chains mean that how this plays out is going to affect all of us, not just the Chinese.

The second paper on price inflation by Xi Chen and Michael Funk considers the potential for a house price bubble in China. The authors deploy a recently developed methodology for identifying potential speculative bubbles in real time, an approach that may assist in constructing early warning systems in future. Although there has been a phenomenal real estate boom in the 2000s, one which received a boost from China's 2009 fiscal stimulus package, it appears that house prices are not significantly disconnected from fundamentals. A bubble in the period 2009-10 appears to have disappeared, in part due to "cooling down" policy measures. In general, then, there is little evidence of a speculative house price bubble, although the authors remain cautious about potential developments in coastal areas of China.

Our final paper by Lili Kang and Fei Peng examines trends in productivity growth and labour costs in China. These are fundamental to China's economic prospects. If you examine a league table of productivity levels across countries you will see that the leading economies are the United States, Germany and some of the other highly developed western economies. If China is to be a top player globally it needs to foster very substantial productivity growth. This entails fundamental transformation of the Chinese economy, away from exporting cheap goods and towards being a producer of high value-added goods, often for consumption by an increasingly sophisticated domestic market. The implication is that it may not be enough for China to be the place where the world's Apple products (and, more recently, Land Rovers) are made. Instead, China will be looking to shift towards the Silicon Valley end of the production chain where ideas are spawned and innovation is key. What is often overlooked in such debates is the degree of heterogeneity there is in the cost competitiveness and productivity of China's regions. Kang and Peng examine trends in unit labour costs across China's regions over a 35-year period for nine single-digit industries. What they find is a remarkable improvement in the relative competitive position of the Interior as measured by declining relative unit labour costs, such that its level of unit labour costs is now on a par with the Coastal region, which is renowned as the most dynamic region in terms of productivity. There has been relative stability over the whole period in competitiveness of the West and Coastal regions, with the West having by far the highest levels of labour costs. When drilling down to a more disaggregated level, it is apparent that there is very substantial heterogeneity with respect to trends in both labour costs and labour productivity across industry and region. But, in general, the Interior, the West and the Northeastern regions improved their competitive position relative to the Coastal region, primarily through lower relative labour costs than through productivity growth, though the latter were apparent in a sub-set of industries. One might argue that convergence of this nature is good news for China, since it implies a more efficient economy beyond the Coastal region, one which should, in the long run, be better equipped to generate the goods and services that the burgeoning middle classes will demand.

Taken together these papers give a fascinating glimpse inside China's economy. The precise path that China's economic development will take may be uncertain, but there is no doubt that debate over that path, and its implications for the global economy, will attract an ever-increasing number of economists studying China.

References

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