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Sustainability of the Chinese Economic Expansion

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China's economy has developed in such a startling way that most people – economists or not – place, as starting from about 1978, and many are questioning whether or not it can last? At the same time, they are wondering about its effect on the United States, and the world at large, because China is such a big country. In this presentation, we will look at the question: Can the Chinese economic expansion be sustained? Personally, we believe that it is, in fact sustainable, not necessarily at the present speed, and cannot say confidently that it will, in fact, be sustained. However, we have been “bullish” on China ever since visiting the country in 1979 and have been

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² Wendy Mak presently specializes in research on China and other Asian countries at the University of Pennsylvania. Prior to that, she worked as an economist with Global Insight. Mak graduated from the University of British Columbia, where she obtained a Bachelor of Commerce degree in Finance and an MA degree in Economics.

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tracking the course of forecasts about performance ever since. Now, we are on a bi-weekly schedule of producing and studying the statistical outcome in some detail.³

Some Macroeconomic Guidelines

The overall status of a major economy is best shown, in my way of thinking and analysis, by such statistics as GDP, population, inflation, foreign trade. Graphs of such variables, starting when possible, from the beginning of reform in 1978 are available. For more intensive work, that is now being undertaken for careful forecasting use, China cannot be studied at the monthly frequency, in general, until some time in the early 1990s. For purposes of annual modeling, some data starting from 1978 are available, but monthly series to be used for intensive short-run forecasts, begins some time before 1995.

In order to gain some impressionistic ideas about Chinese economic performance, we can consider the following charts on an annual basis. First, let us look at the time shape of real GDP. [See Graph I, I-A GDP graph.] The ordinates vary from 104 to 116 meaning 4% growth over the preceding year to 16% over the preceding year. There were two weak growth years 1989 and 1990, in connection with the Tiananmen Square demonstrations; otherwise the growth-bars are above and below 8% annual growth, and this is surely a very impressive record. We cannot find one parallel performance, in any place or in any such extended time period. There are 8-10% Chinese growth spurts, here and there for a few years, but certainly very few; near 8% or more, year after year, without interruption.

There have been challenges to the reliability of these estimates, but we find these challenges to be based on poor reasoning or faulty pieces of information. In a previous appearance before this organization, different reasoning was presented, and we feel comfortable in using the official data.⁴ Year-after-year, competing nations complain bitterly that China is growing too fast for others to match. This is hardly supportive of the claims that the figures are distorted upwards.

China is a very large country, although its population count may soon be surpassed by India, its Asian giant competitor. It is easy to see, from this chart on income per capita, that an accelerating take-off occurred after about 1990, although China has a very long road to travel ahead if they are to catch-up to US figures on levels (not rate of growth) of per capita income. [See Graphs I-A and II, Population graph.]

The population, now reaching 1.30 billion persons, could pose some problem ahead. Japan once looked very impressive in the period of post World War II reconstruction and has now leveled-off so much that it fears the existence of economic difficulty; at very, very slow growth because Japanese families had so few offspring. Is China heading in the same direction as a result of having very small families and not welcoming immigrants? Somewhere down the expansion road, it is entirely possible that China could be approaching the Japanese slow growth situation unless they take steps to relax the one-child-per-family guideline.

Inflation started to get out-of-hand, in the late 1980s and again in the early-to-mid-1990s, but corrective action has been taken, and China is down to one-digit percentage growth, a good position for sustainability, as we examine that concept. [See Graph III, CPI graph.]

³ With the extremely able assistance of Wendy Mak, I am able to look at China's economy on a fortnightly basis. [Klein]

⁴ See L. R. Klein and Suleyman Ozmucur, "The Estimation of China's Economic Growth Rate", *The Journal of Economic and Social Measurement*, 28 (187-202), 2002-2003.

The bothersome competitive wedge of China is feared by the United States, and we can see an accelerating export growth in China during recent years, especially after the lifting of textile trade restraints. [See Graph IV and IV-A, Export graph.] Other market economies show the same fear, but the complaining trade partners fail to look at their own mistakes or poor economic policies that leave them in weak competitive positions. It hardly seems right to blame China if they are producing so much for sale at favorable prices to the buyers. The complaining nations should be examining issues at home and correcting them by policy actions so that they, too, can be favored exporters.

Finally, in this brief chart showing trade [see Graph V, Import graph], we come to China's imports, which create market opportunities for other countries. Some of these countries, doing well as a result of China's imports, complained in the period 1994-97, when China consolidated exchange rates in a move that satisfied many market economies. They are now having a marketing bonanza, as a result of China's buying spree, for their output, to satisfy China's vast import appetite.

China consolidated diverse exchange rates, January 1, 1994, and effectively implemented a competitive position via elasticities of substitution, from which we and some colleagues showed that competing East Asian countries priced themselves out of the market by trying to stick to a currency peg with the US dollar. The problem for the East Asian countries was not that China was "stealing" their exports; it was that other countries pegged to the dollar at a time when the US currency was very strong, and thereby priced themselves out of the market.

Now the situation has completely changed. Instead of losing trade, on the basis of competition, to China, other developing countries (East Asia plus Mexican or other Latin American countries) are, or should be, grateful to China for exhibiting such great import demand from them at the present time. In many respects, China is helping to keep much of the world afloat, just the thing that a strong country should do in the face of a currency crisis. In this respect, China adhered to the wishes of the US Administration that they should be a main stabilizer in Asia.

China's Recipe for Success

After 1978, what was China's development policy that realized such great success? The hallmark of China's policy was "Step-by-Step gradualism". This is just the opposite of "Shock Therapy", which was unfortunately recommended by misguided market zealots for states of the former Soviet Union (FSU).

China, on the other hand, freed up agricultural work and decision making. They did not give farmers landed property. Instead they allowed farmers to make their own agricultural decisions and also have the right to pass on their plots to succeeding family members. This brought forth a surge in production and enabled China to solve, on average, their food problems.

Driving through the Chinese countryside at dusk, one could see eager farmers hard at work on their "own" plots, trying to maximize returns according to good economic principles. This was far different from countryside vistas of work gangs with hoes and shovels before liberalization.

The next gradual step involved small mercantile enterprise. This, too, was successful. Merchants set up shop in stalls and competed with one another in selling textiles, shoes, items for the home, jewelry, etc. These shopping areas expanded into markets for local produce and, for the off-season, there appeared "Town and Village Enterprises" (TVEs) dealing with small machine tasks and whatever activity could be handled in small sheltered work areas. Some of

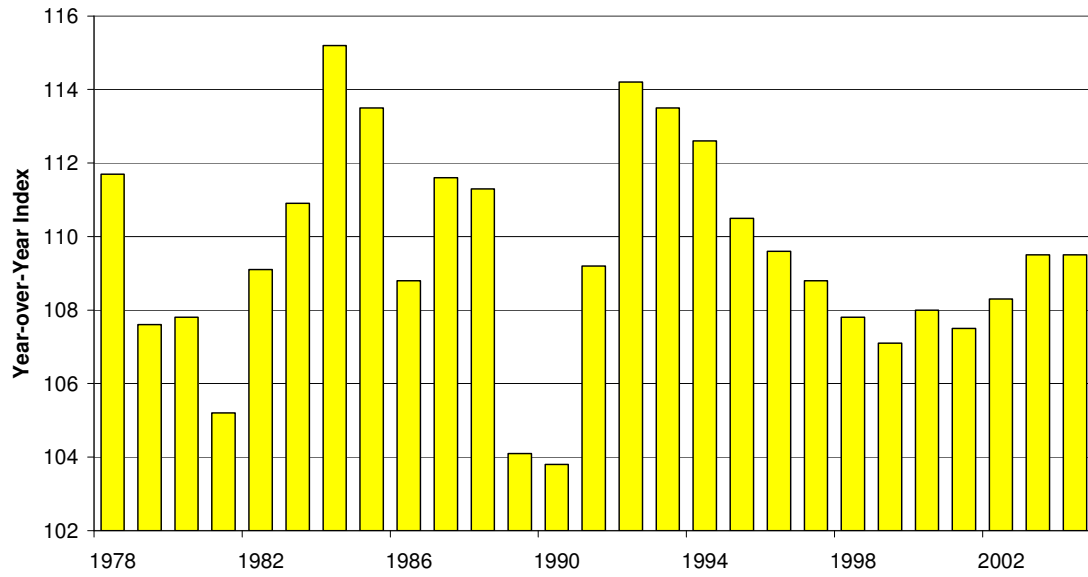
the TVEs eventually expanded into significant establishments with scores or even hundreds of employees.

In various parts of the world, particularly in Taiwan, there appeared “Export Processing Zones” that benefited from special duty allowances, enabling small manufacturing enterprises to compete on cost-of-production with large establishments. China added a new twist, namely, Special Economic Zones (SEZs). These were restricted areas for some foreign firms (with space for living quarters), some domestic firms, and “gated” communities for family living. Families had to justify for permission to live in the Special Economic Zones. Now, one can find large and very productive Science or High Tech Parks, the world over, with some features of the SEZs, but probably more open environments and less strict rules; but it should be recognized that the TVEs and SEZs formed the breakthrough activities that fired the rocket-like growth of the Chinese economy.

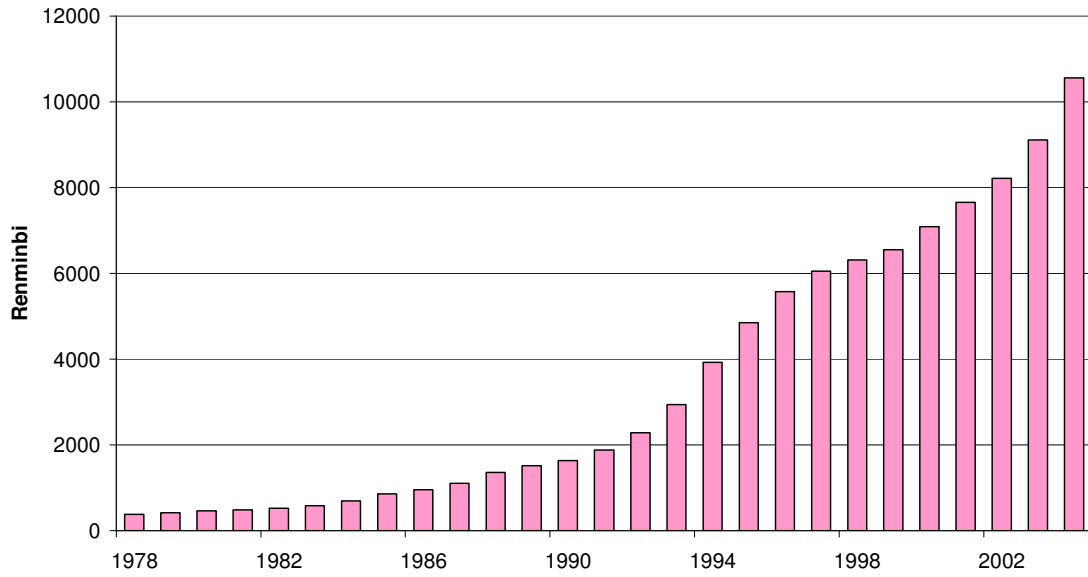
Infrastructure was, of course, needed in order to blend into this burgeoning set of market-based activities. The infrastructure, which had to be provided from scratch, consisted of modern highways, fleets of reliable cars/trucks, airports, supermarkets, hotels, conservation systems, modern factories, large apartment buildings, communication systems, facsimilies, wireless computers, luxury goods, and all the trappings of an affluent society which is being realized in stages, but with the various steps or stages rapidly following one another.

In order to stretch macroeconomic success over more years and decades, China is trying to realize a managed slowdown of the overheated economy – in terms of somewhat reduced GDP growth; i.e. from more than 9.0 percent annually to something closer to 7.0 to 8.0 percent. [See Graph VI, GDP Forecast Graph.] At the same time, Chinese authorities are trying to engineer a gradual slowing of inflation expansion. Our fortnight-by-fofortnight calculations, with short term extrapolations, suggest that the policy targets are gradually being met. [See Graphs VII and VIII, CPI and PPI Forecast Graphs.]

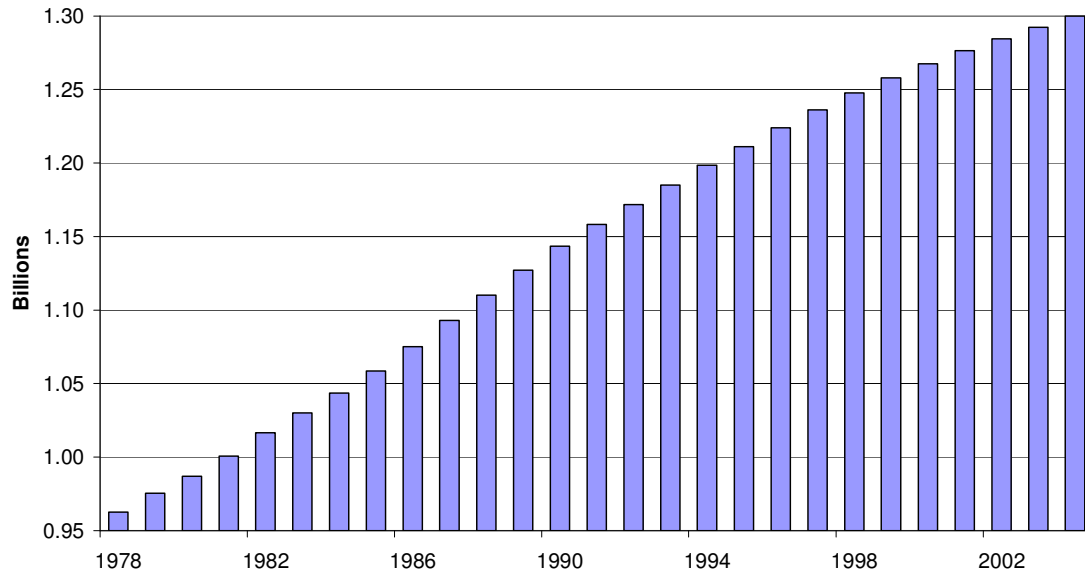
Graph I
Gross Domestic Product (1978 – 2004)



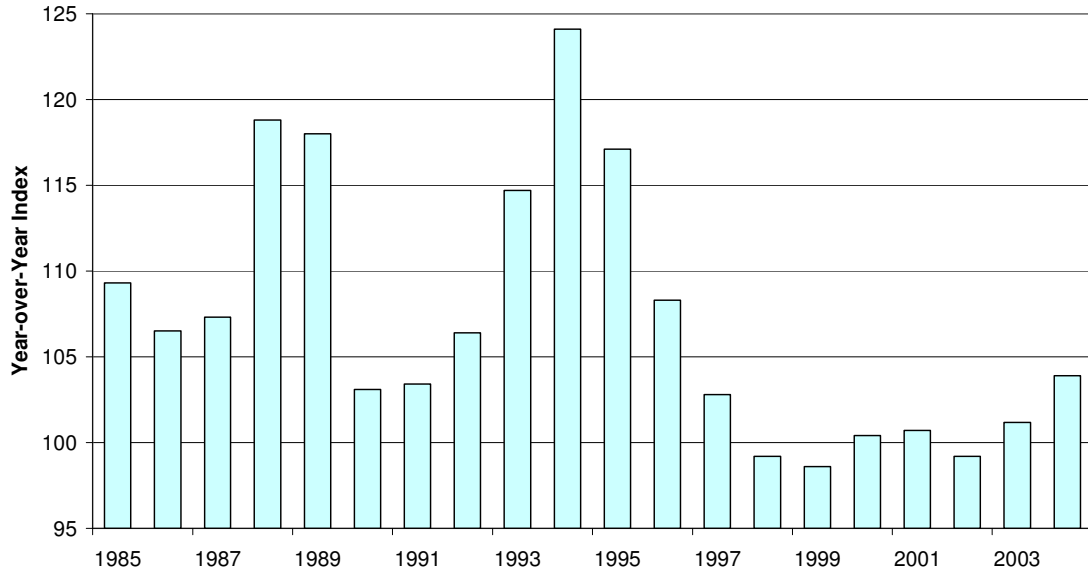
Graph I-A
GDP per Capita (1978 – 2004)



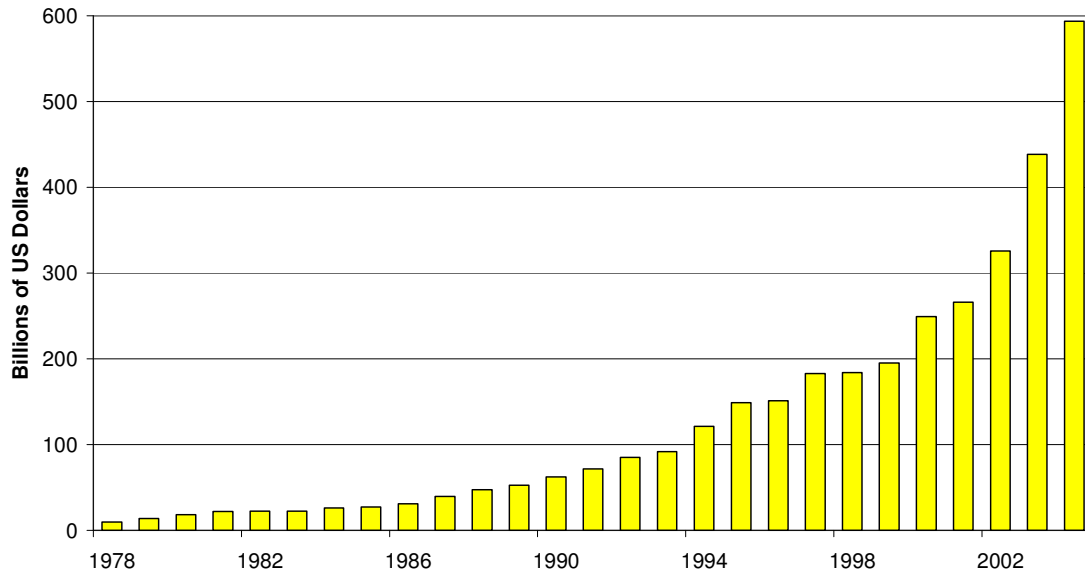
Graph II
Population (1978 – 2004)



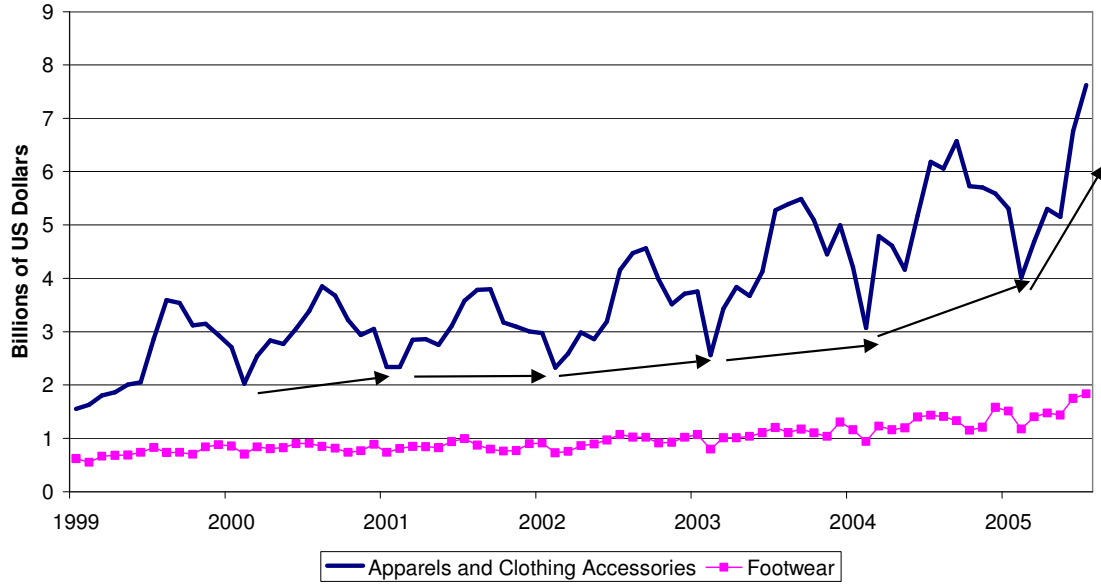
Graph III
Consumer Price Index (1985 – 2004)



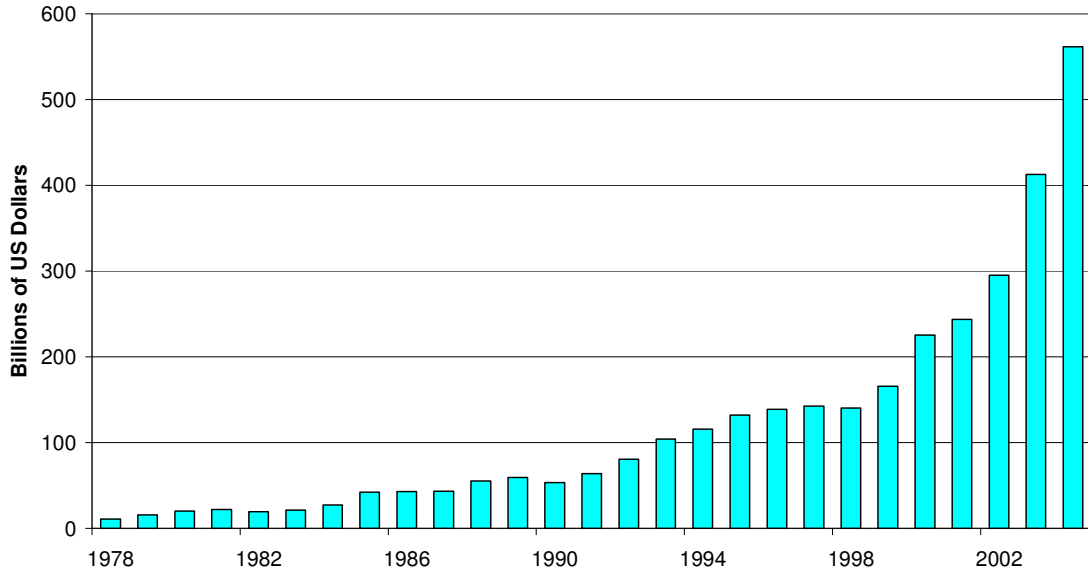
Graph IV
Exports (1978 – 2004)



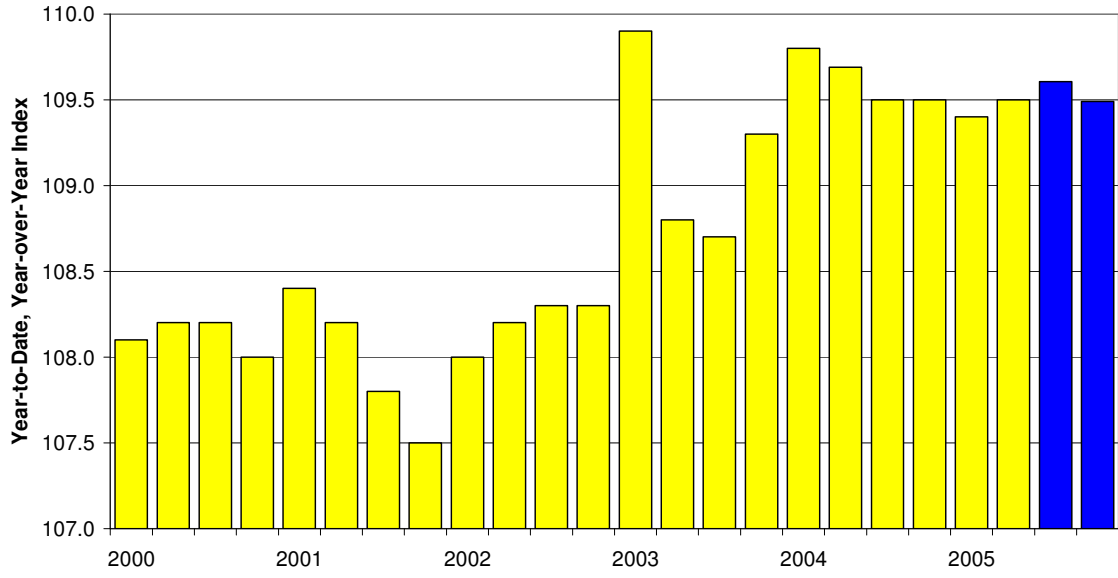
Graph IV-A
Chinese Exports of Textile Products (January 1999 – July 2005)



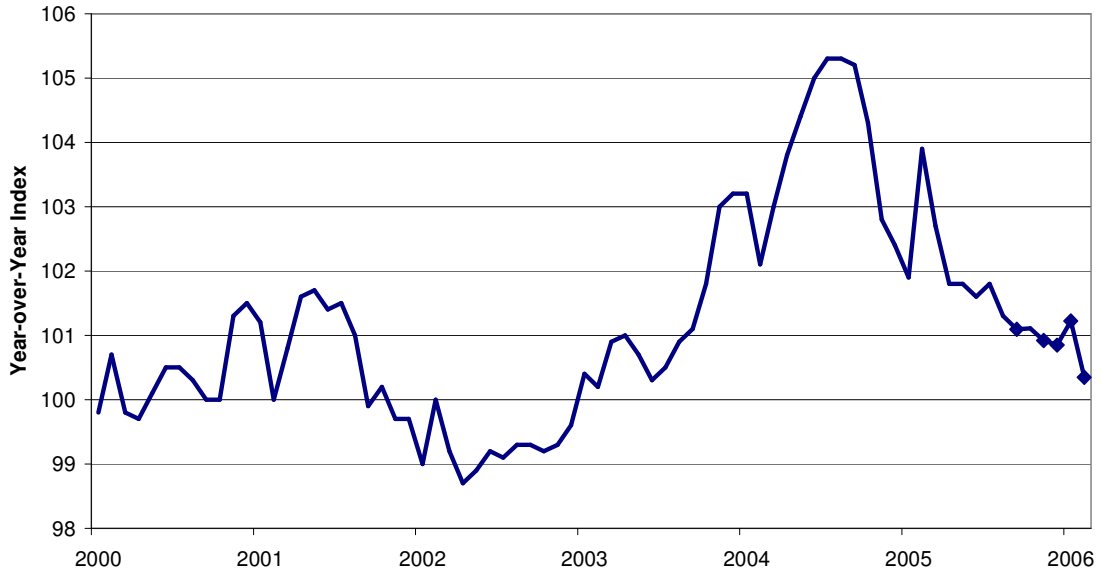
Graph V
Imports (1978 – 2004)



Graph VI
Gross Domestic Product (Forecast Period: 2005Q3-Q4)



Graph VII
Consumer Price Index (Forecast Period: September 2005 – February 2006)



Graph VIII
Producer Price Index (Forecast Period: September 2005 – February 2006)

