Asia – Challenges of Growth and Stability

China’s Prospects and Regional Implications

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Three Key Questions

• Can China continue to grow at 7-8% for the rest of this decade?

• What are its vulnerabilities and is rebalancing the solution?

• How will China’s performance affect Asia?

What makes China different is its size and regional differences.
Regional Patterns Shape GDP Growth
Most analysts see China’s unbalanced growth as its vulnerability.
What caused these imbalances?

• Declining consumption share of GDP comes from an urbanization process. The transfer of labor from agriculture to industry causes labors’ share of income to decline relative to GDP and explains the drop in consumption share.

• Both the decline in consumption share and the corresponding surge in investment share reflect the priority that China gave to developing the far west beginning in the late 90s.
Declining consumption share driven by the West
(regional household income/GDP)
How does labor migration affect the national accounts?

**Farmer**
- Value of rice = 10,000
- Income = 9,000
- 7,000 consumed, 2,000 saved

**Factory Worker**
- Value added of iPod = 60,000
- Wages = 30,000
- 15,000 consumed, 15,000 saved

Labor share of output goes from 90% to 50%
Consumption share of GDP goes from 70% to 25%
Regional factors also explain IMF’s noted deviation between “norm” and actual investment.

Figure 7. China: Investment-to-GDP (Actual and predicted)
“Develop the West” becomes a priority
(Regional Investment rate as % of GDP)
Investment Efficiency (ICOR) is a problem primarily in the western region.
China’s unbalanced growth path resembles other successful Asian countries but is more extreme.
Potential Sources of Growth

• Underlying sustainable growth rate has fallen from historic 10 percent to around 6-7 today. China can no longer rely on investment growth and easy TFP increases.

• Cutting back on the inefficiencies due to the regional balancing programs is part of the answer.

• The rest must come from reforms that will add another 1-2 percentage points in productivity increases: more efficient urbanization and greater role for the private sector.
Urbanization drives services but China lags
The productivity gap between state and non-state firms is widening

Return on assets, by type of industrial firm
China’s performance will affect the region through:

- Increased outbound FDI/capital flows
- Evolution of the production sharing network
- Regional trade patterns
- Exchange rates
- Wages
Figure 1: China’s International Investment Position, 2004-2012
USD billion, total stock, assets (+) and liabilities (-)

Source: PBOC, SAFE, RHG. *Other Investment category includes trade credit, loans, currency and deposits and other investment.
Regional Production Sharing Network – specialization and scale – will this pattern change?
China's trade balances with the US, EU, Canada, select Asian economies, and other commodity exporters

*Selected ASEAN includes Malaysia, Philippines, and Thailand. Other commodity exporters includes countries who had trade surpluses with China in 2010 and exported more than $1 billion in primary commodities to China in 2010, excluding Hong Kong, Singapore, and the other economies depicted.
Regional exchange rates are now mirroring China’s movements?
## China’s impact on regional real wage growth rates

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<th>Country</th>
<th>2000-2005</th>
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