<u>Workshop on "The World Economy under High Uncertainty"</u>

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Making Sense of China's "New Normal Economic Growth"

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Visions of the “New Normal”

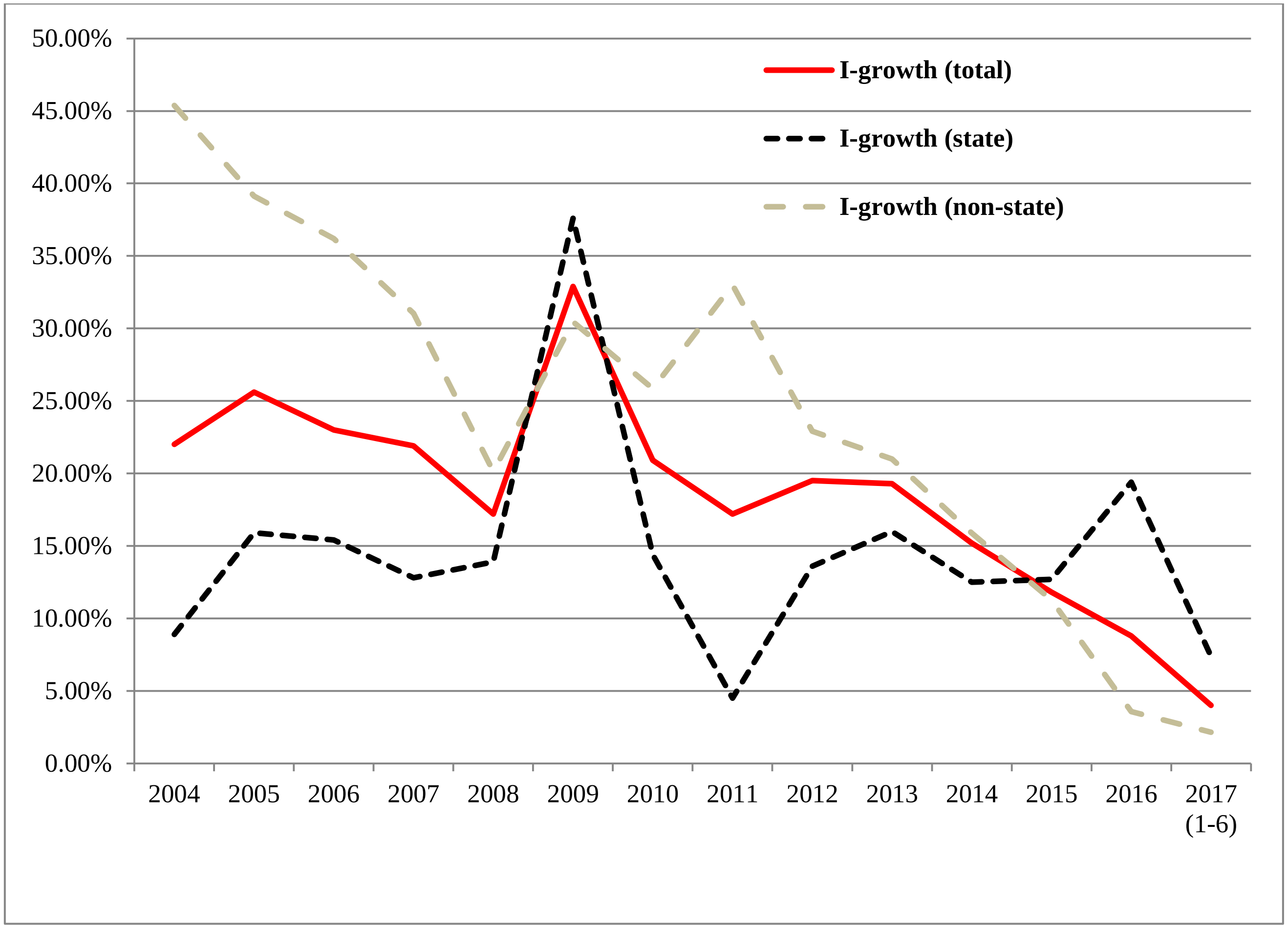
- Slow-down in economic growth, long-term, is the defining characteristics of China’s “New Normal”. Ostensibly, the immediate cause is investment stagnation, esp. non-state investment (Figure 1).

- But, what are the more basic causes? And what are the underlying structural-institutional conditions? Ultimately, what direction for Chinese economic transformation – in order to sustain medium-speed growth, or even to resume high-speed growth?

- Existing interpretations of the growth slowdown have coalesced around two theses: namely, demand deficiency and profitability decline. State policy has hitherto sought to address the major issues raised by these interpretations, mostly in a piecemeal way.

- In view of the main policy attempts for almost 10 years post-2008, and the mixed outcomes, it appears that a more systematic approach is needed for sustaining long-term growth.

Figure 1. Real annual growth rates of investment (%)



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Sources: Chinese National Bureau of Statistics, *China Statistical Yearbook 2016*, *China Statistical Yearbook 2017*, and NBS data bank.

Notes: Investment refers to total fixed-asset investment. Its growth rates are computed by using the investment price index as deflator.

Demand Deficiency

- Causes of investment stagnation: demand deficiency and profitability decline (Figure 2).

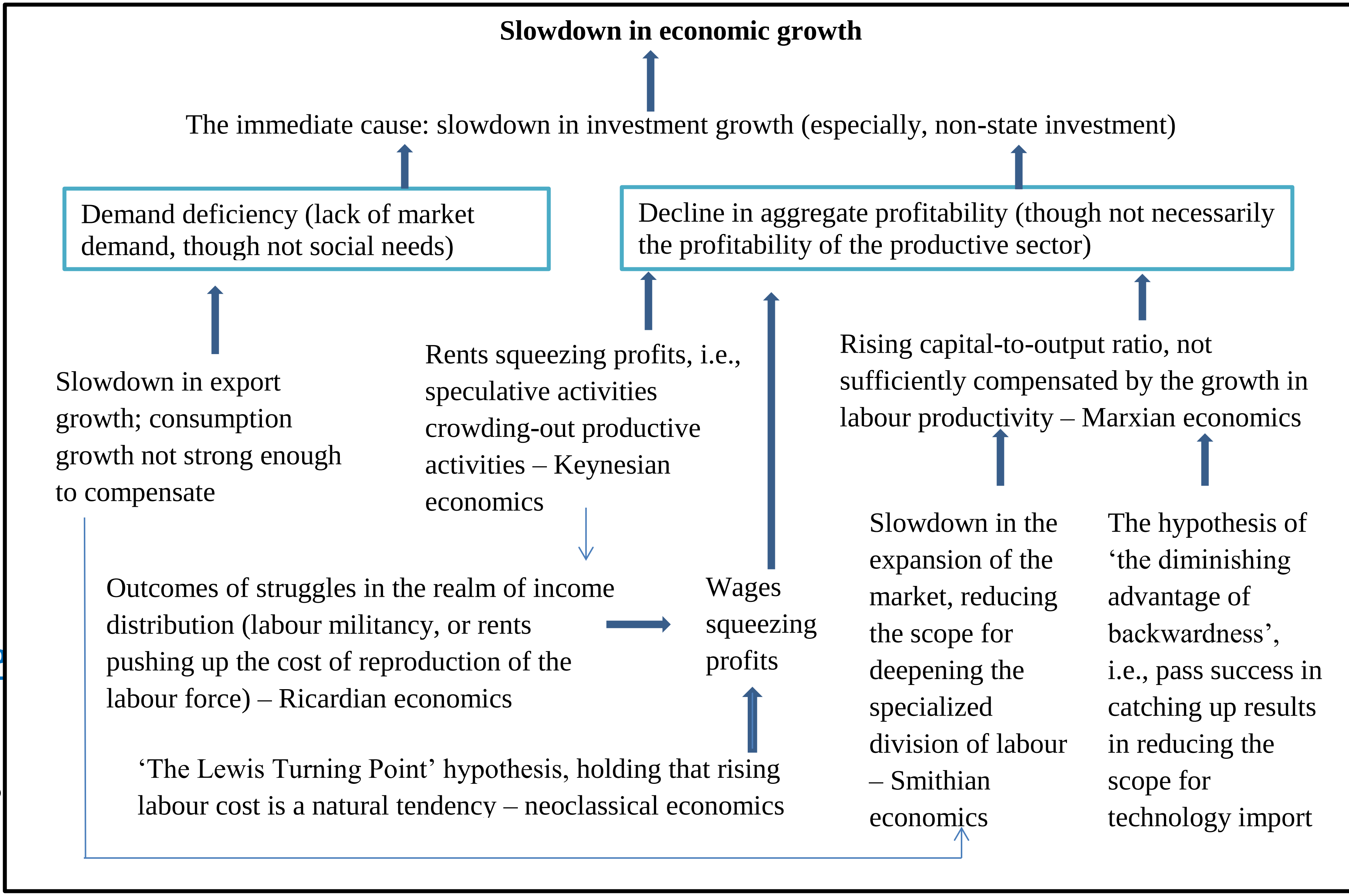
- Demand deficiency: excess capacity, trade friction… factories closure and inventories piling up, esp. blocks of unoccupied or semi-completed residential properties.

- The thesis of imbalances in the composition of aggregate demand.

- Under-consumption reflects uneven income distribution, and “ghost towns” reflects market demands vs. social needs, both – together with the predominance of non-state investment – indicating the prevalence of market relations in the economy.

- Hence the policy objectives of rebalancing and restructuring.

Figure 2. Alternative explanations of the slowdown of Chinese economic growth

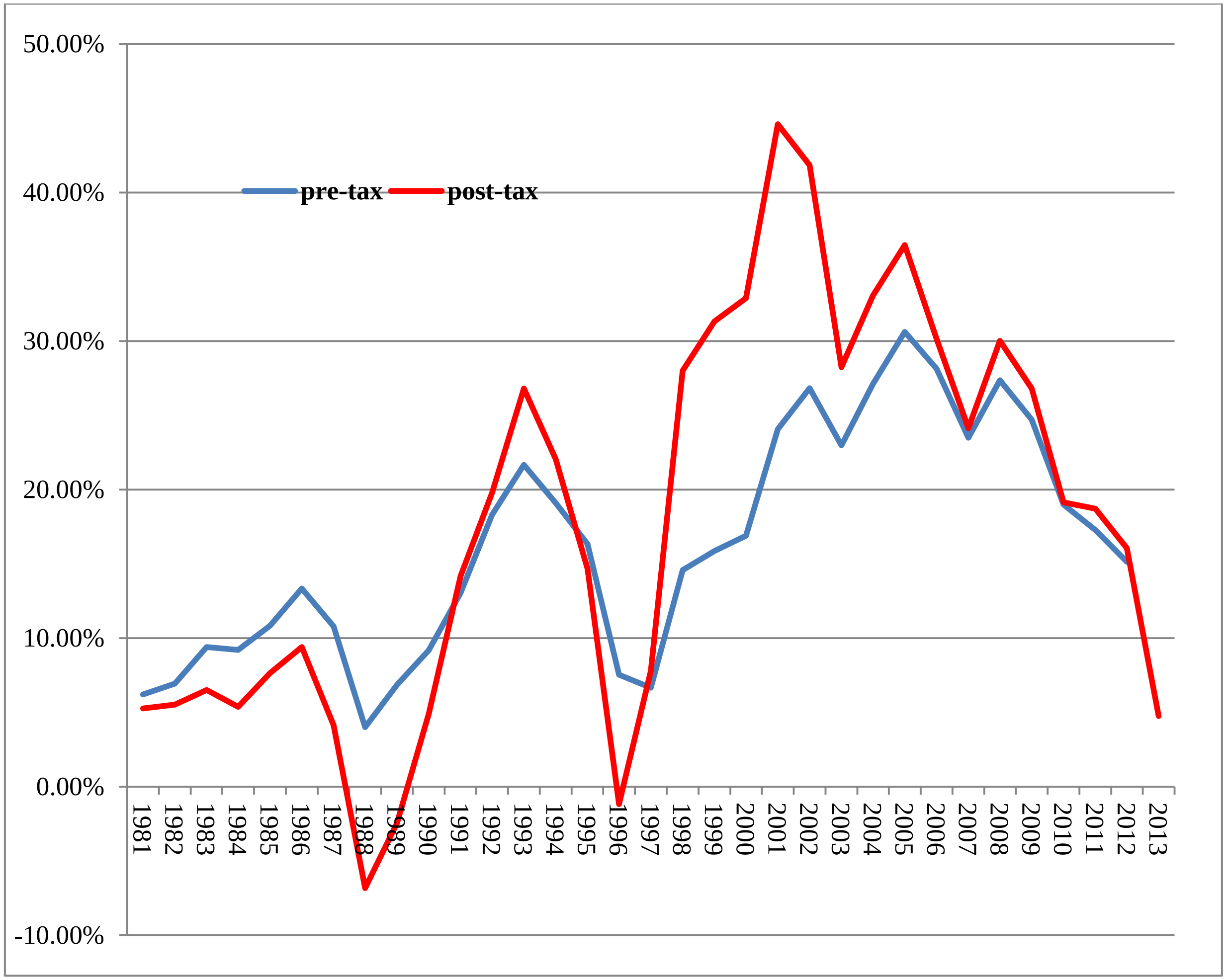


- But is profitability decline true? Growth of industrial profits falls, but profit rates remain at high levels (Figure 3 and Figure 4). For aggregate profitability, most estimates find that there is indeed a trend of secular decline – starting from circa 2005 and worsening post-2008.

- What accounts for the divergence between industrial and aggregate profitability? Possible reason: speculation crowding-out production, i.e., the allocation of an increasingly bigger share of total capital to speculative sectors – a story of rents squeezing profits.

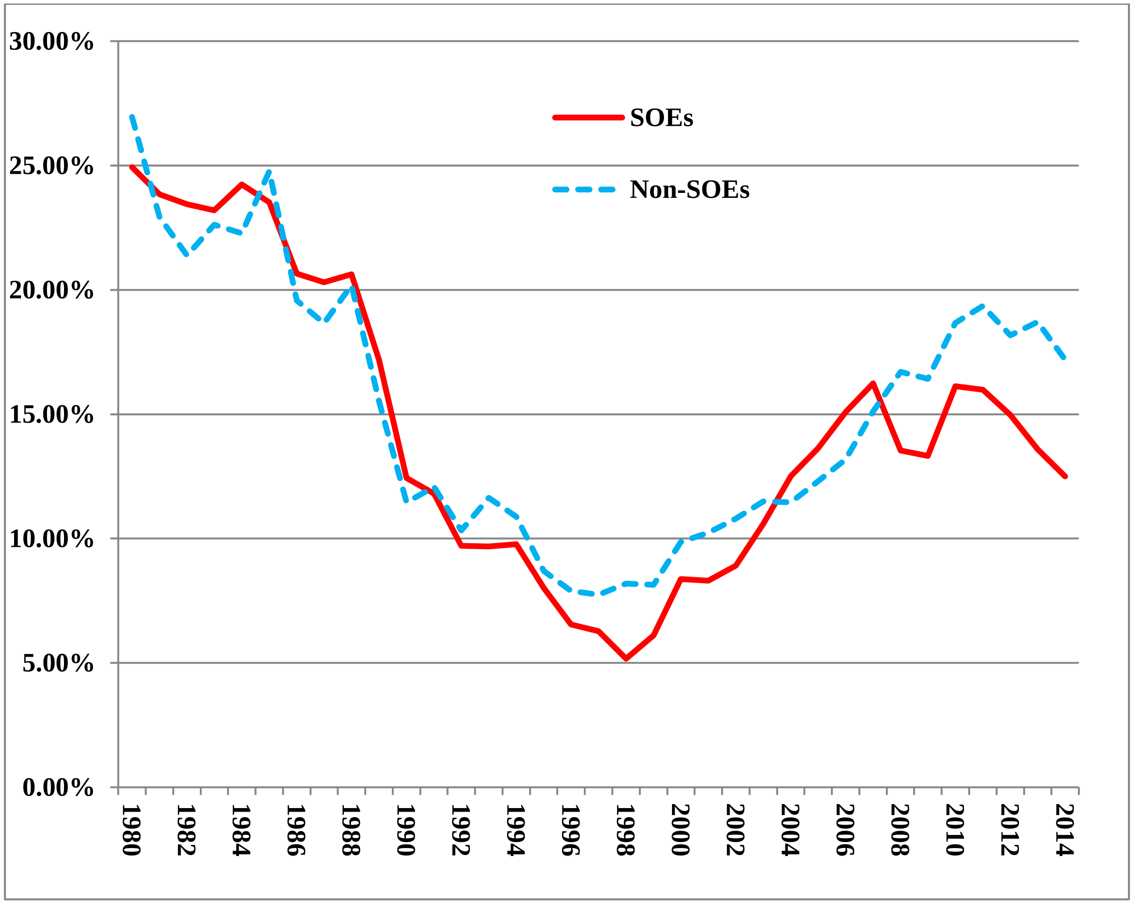
- Under the New Normal, financialization takes the form of the massive expansion and then the booms and busts of the real estate sector, and of the stock market.

Figure 3. Nominal annual growth rates of industrial profits, 5-year moving averages (%)



- Sources: Chinese National Bureau of Statistics, *China Statistical Yearbook 2016*, and NBS data bank.

Figure 4. Pre-tax profit rates of industrial enterprises (%)



Sources: Chinese National Bureau of Statistics, *China Statistical Yearbook* and *China Industrial Economics Statistical Yearbook*, various issues, and NBS data bank.

Notes: Pre-tax profit rate = (total taxes + total profits) / (working capital + net value of fixed assets). Non-SOEs in this figure refer to non-SOEs in the formal sector of Chinese industry.

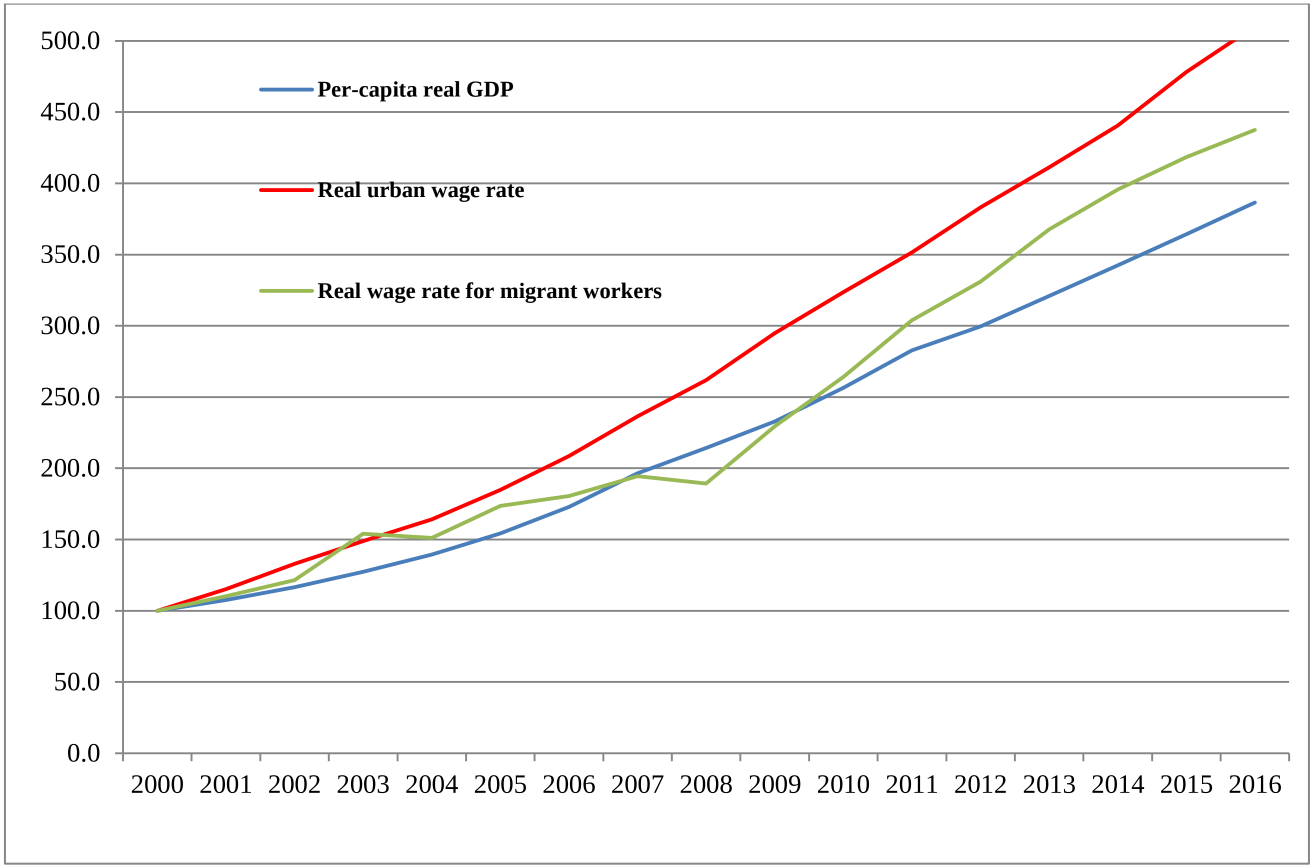
- The story of wages squeezing profits, i.e., "cheap labour" no more, has its empirical backing in the form of fast wage growth since the turn of the century (Figure 5).

- This story is associated with three different theories: (1) the "Lewis Turning Point"; (2) labour militancy; and (3) wage growth masking rents rise. Of the three theories, (2) appears to be containing more elements of empirical truth.

- The story of the rise in capital-to-output ratio undermining profitability, for applying to China's New Normal, is most consistent to Marxian theory. Conceptually, it could be caused by (a) decreases in labour extraction, (b) demand deficiency, or (c) the exhaustion of the "advantages of backwardness". It appears that (c) contains more elements of empirical truth.

- Overall, it appears that the causes of the investment stagnation, and hence growth slowdown, are complex and multifaceted. A systematic understanding, and policy responses, is needed.

Figure 5. Indices of per-capita real GDP, real wage rates



Sources: Chinese National Bureau of Statistics, *China Statistical Yearbook 2016*, and *China Statistical Yearbook 2017*.

Reshaping the Model of Economic Transformation

- In the period 2000-2012, China experienced synchronous growth, all on unprecedented fast rates of investment and consumption, and of productivity and the wage rate. These provided the material conditions for broader social developments.

- Table 1: the unprecedented fast pace of growth in per-worker GDP in 2000-2012, and the abrupt slowdown thereafter. This trend of evolution is similar to the growth in wage rates, already indicated in Figure 5.

- These trends of productivity and wage growth have been underpinned by investment growth, and accompanied by consumption growth. Table 2: the unprecedented fast pace of growth in both investment and consumption in 2000-2012, and the abrupt slowdown thereafter.

- A balance seemed to be in existence between these two pairs of variables, thereby generating the good outcomes in terms of both economic and social development.

Table 1. Average annual growth rate (%) of real GDP and employment

	(a) Real GDP	(b) Employment	(a)-(b)
1978-2000	9.68	2.02	**7.66**
2000-2012	10.19	0.52	**9.67**
2012-2016	7.13	0.29	**6.84**

Sources: Chinese National Bureau of Statistics, *China Statistical Yearbook 2016*, and *China Statistical Yearbook 2017*.

Table 2. Average annual real growth rates (%) of consumption and investment

	Consumption	Investment
1978-2000	8.92	9.35
2000-2012	10.14	15.01
2012-2016	8.06	7.04

Sources: Chinese National Bureau of Statistics, *China Statistical Yearbook 2016*, and *China Statistical Yearbook 2017*.

Notes: Data are consumption and investment (i.e., gross capital formation) components of GDP by expenditures approach. Consumption growth is deflated by the consumer price index; investment growth is deflated by the investment price index.

- This is similar to the experience of the Golden Age of the advanced countries in the period 1950-1973. Theoretically, the Golden Age Model can be characterized as having as its pillars the three agents of ‘Big Business, Big Labour, and Big Government’.

- In the case of China, in the period of 2000-2012, along with rapid investment growth was the famous phenomenon known as ‘*guo jin min tui*’ (the state sector advances, whilst the private sector retreats). The state-owned enterprises (SOEs) are the Big Business in China.

- The nascent formation of Big Labour is evident not only in the wage growth but also in institutional and policy moves such as minimum wage legislations, the Employment Contract Law, collective bargaining, unionization, etc.

- Big Government takes the form of the state orienting itself towards rebuilding a comprehensive (although still primitive) welfare system, as well as its active role in infrastructural investment and science and technology investment.

- The recurring disruptions to the path of convergence to the Golden Age Model under the New Normal could be attributed to the process of financialization of the economy.

- This can be gauged by observing the massive expansion in the stock of ‘total social financing to the real economy’ (TSF): in the years 2003-2008, the ratio of TSF to GDP remained basically unchanged. Thereafter, it surged from 149% in the year-end of 2008 to reach 208% by the year-end of 2016.

- Chinese banks, of which the biggest ones are all state banks, have traditionally been under tough government controls and regulations. The process of financial liberalization post-2008, however, has largely set them free in participating in speculative activities (shadow banking activities…). Non-bank financing activities have been subject to even less government controls and regulations. The fact that both types of financing have expanded tremendously can only result in the precipitation of capital in speculative activities.

Concluding Remarks

- The cause of the slowdown in investment growth, and therefore economic growth, in China under the New Normal is complex and multi-faceted.

- Since the turn of the century, there has been a rivalry between two alternative directions for Chinese economic transformation: the convergence to the Golden Age Model versus the tendency of financializing the economy.

- After the stock market crash in summer 2015 and the continuous worsening of economic performance, the Chinese state leadership has reoriented itself to turn to emphasise curtailing speculative activities and promoting productive activities.

- Whether this orientation can achieve the hoped-for outcome of medium-speed or high-speed economic growth, however, remains to be seen.