China’s Economic Transformation: Myths and Realities

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Development Strategy

1. Urbanization
2. Industrialization
3. Globalization
4. Reform

- “Reform is China’s Second Revolution”—Deng Xiaoping
Reforms, Reforms, Reforms

- 1980s: Experimentation with Special Economic Zones
- 1990s: Privatization
- 2000s: Trade liberalization
- Recent Third plenum reform package: credit and financial market imperfections
Myth 1: Investment-Driven Growth Model?

- Output = F(Technology, Capital, Labor)
- High investment rates in the 1990’s (over 30%)
  - Curse of **diminishing returns**?
  - But...high rates of return (well above 20%) and increasing in the 1990’s.
China-Style Growth

- Growth through *rereallocation* of resources (*labor*) between 1978-2007:
  1. Rural-Urban: share of labor in agriculture (70% to 30%)
  2. State-private: share of state employment (in non-agriculture sectors) (52% to 13%)
Productivity Growth between 1978-2007
- State sector (1.52%) vs. Private (4.56%)
- Reallocation of labor from state to private
- Also, rapid productivity growth in private helped absorb labor transferred out of agriculture (420 million jobs)
- Absent private sector productivity growth, GDP/per capita growth 3.79% lower annually
- If not for the large capital misallocation, even larger gains.
So far, there is significant misallocation of capital. In non-agriculture sectors:

- State Employment Share: 13%
- Investment Share: 53%
- GDP share: less than 30%
The Next Big Thing

- Next: *winnowing distortions* and reducing the misallocation of capital
  - Catching up with U.S. financial efficiency leads to a GDP increase of 60-100%
  - Eliminating differences in return to capital of firms can lead to productivity gain of 160-300%
source: Brandt and Zhu (2010)

Bottom line: even reallocating existing resources can lead to high growth.
Putting Things into Perspective

Real GDP per capita (PPP)

source: data from WDI
Myth 2: China’s High Saving Rate

source: Song and Yang (2010)
Why is it a puzzle?

How can we explain it?
- Two criterion: **levels** and **growth**
- Corporate vs. Households; Urban vs. Rural

Popular wisdom and challenges
- Culture, social safety net, precautionary saving...
Exp 1: Gender Imbalance

SEX RATIO
For every 100 female births there are 117 male births

Male births
111.36 116.86 119.25 120.22 120.56 119.45 117.94 117.78

Source: National Bureau of Statistics
GUILLERMO MUNRO / CHINA DAILY
And The **Scramble** for Wives

source: Wei and Zhang (2009)
Gender Imbalance and Competitive Saving

Source: Wei and Zhang (2009)
Solution: Outsourcing

Mail-order brides

source: tiboo
Exp. 2: The One Child policy

Fertility (number of surviving children in an household)

source: Choukmhane, Coeurdacier and Jin (2013)
## Twin Experiment

<table>
<thead>
<tr>
<th>Household Saving Rate</th>
<th>Only Child</th>
<th>Twins</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Average</strong></td>
<td>21.3</td>
<td>12.8</td>
<td>8.5</td>
</tr>
<tr>
<td><strong>Income Quintile (low to high)</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>6.4</td>
<td>-2.9</td>
<td>9.3</td>
</tr>
<tr>
<td>2</td>
<td>18.3</td>
<td>16.6</td>
<td>1.7</td>
</tr>
<tr>
<td>3</td>
<td>23.7</td>
<td>10.3</td>
<td>13.4</td>
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<td>4</td>
<td>27.4</td>
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<td>5</td>
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<td>25.4</td>
<td>8</td>
</tr>
</tbody>
</table>

Source: Choukmhane, Coeurdacier and Jin (2013)
The Transfer Effect

Census 2005 - Main source of livelihood (65y+)

- Family support, 56.65%
- Pension/wealth income, 24.72%
- Labor income, 12.90%
- Other sources, 5.73%

Charls 2011 - Expectations of old-age support (45-65y)

- Children, 49.49%
- Savings & pension, 45.59%
- Other sources, 4.92%

source: Choukmhane, Coeurdacier and Jin (2013)
One Child Policy By-product

source: Choukmhane, Coeurdacier and Jin (2013)
The Human Capital Dividend

- Rapid human capital accumulation
  - Only child 40% more likely to pursue higher education
  - Human capital factor only 50% of US level

- Rapid labor productivity growth
  - Between 2003-2009: on average 12% per year
  - Projected at least 9% until 2020, and 6.7% until 2030

- China ages before it riches: another myth?
  - 0.2% decline in labor force per year until 2020
  - But... rapid labor productivity growth to compensate
Myth 3: What Imbalance?

- The largest imbalance is between government and households.

- **Wage Suppression** and **Financial Repression**
  - wages in manufacturing (7.6%) compared to labor productivity in manufacturing (17%) and real GDP per capita (over 10%) between 1997-2008.
  - Significant declines in labor share
Financial Repression

average real return on bank deposits ≈ 0

source: author's own calculations
China in the Global Economy

Three Global Facts:

1. Saving Divergence
2. Global Imbalances
3. Declining interest rates
source: Coeurdacier, Guibaud, and Jin (2013)
source: Coeurdacier, Guibaud, and Jin (2013)
Figure: Global Imbalances

Current Account (% GDP)
source: Coeurdacier, Guibaud, and Jin (2013)
Heterogeneity in household debt

Household Debt as a % of GDP

source: Coeurdacier, Guibaud, and Jin (2013)
Looking into the Future

- From Cheap Labor to Cheap Capital
- Third Plenum Reform Package
  - Removal of Distortions
  - Improving financial markets...
- Redistribution of Wealth
Intellectual Property Rights

Figure: The “Zhang Laffitte” Chateau

source: 2013 Jens Schott Knudsen (CC BY-NC 2.0)
A Terrible Beauty is Born

1. Social Turmoil or Social decay?

2. Destruction of meritocracy, erosion of Confucian values, and the disruption of the social fabric

3. Proximate factors: (three lacks) legal constraint, religious restraint, and moral responsibilities