

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?

- $\text{Output} = F(\text{Technology, Capital, Labor})$
- 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 **reallocation** 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%)

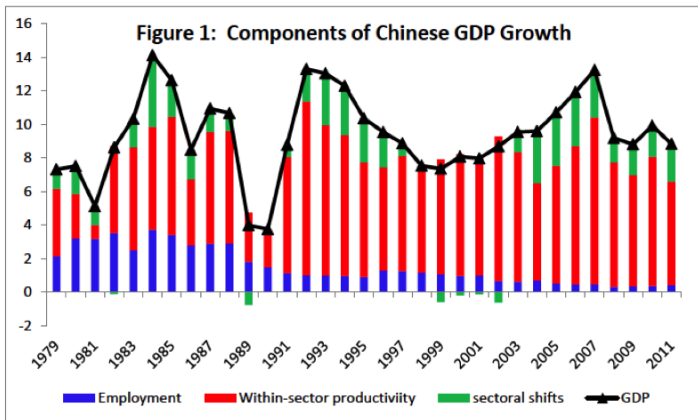
- Productivity Growth between 1978-2007
 - State sector (1.52%) vs. Private (4.56%)
 - Reallocation of labor from state to private
 - Also, rapid productivity growth in private helped absorb labor transferred out of agriculture (420 million jobs)
 - Absent private sector productivity growth, GDP/per capita growth 3.79% lower annually
 - If not for the large capital misallocation, even larger gains.

The Next Big Thing

- 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%

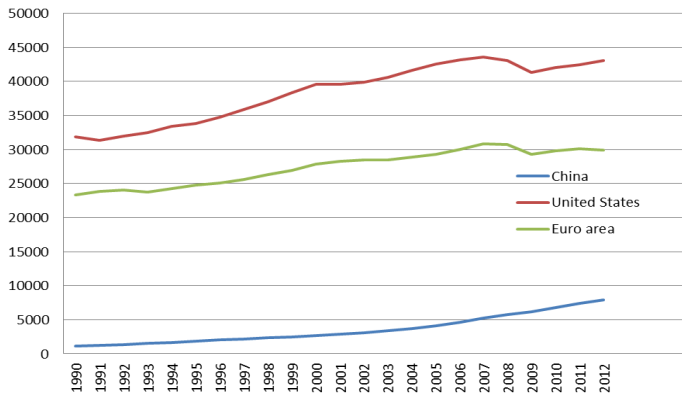


source: Brandt and Zhu (2010)

Bottom line: even reallocating **existing** resources can lead to high growth.

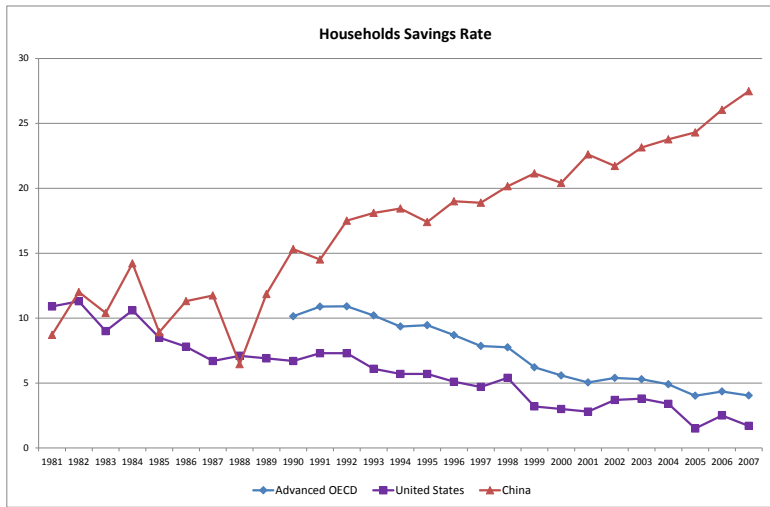
Putting Things into Perspective

Real GDP per capita (PPP)



source: data from WDI

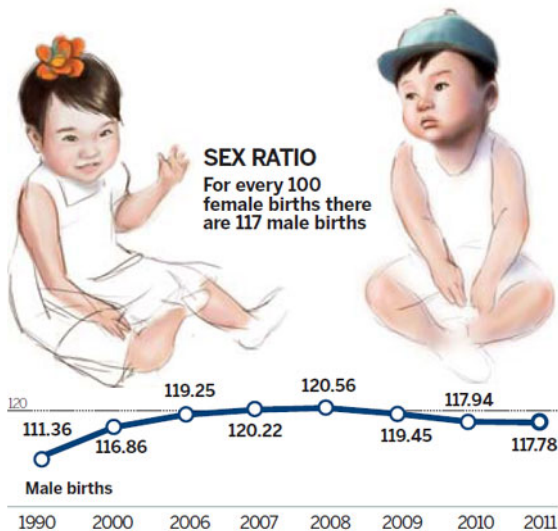
Myth 2: China's High Saving Rate



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



Source: National Bureau of Statistics

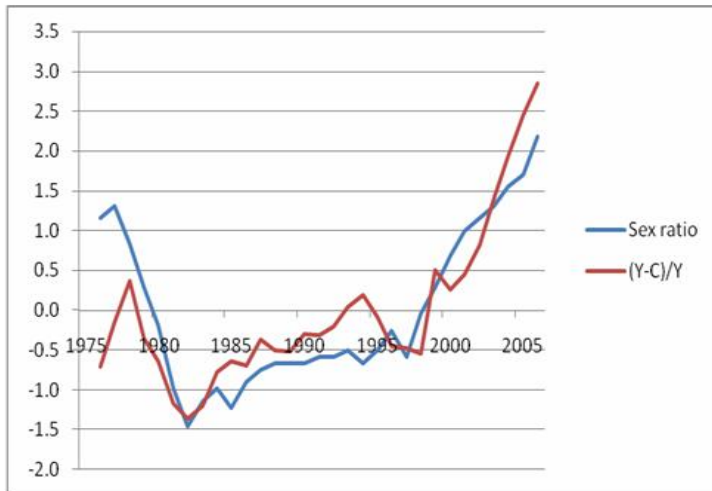
GUILLERMO MUNRO / CHINA DAILY

And The Scramble for Wives



source: Wei and Zhang (2009)

Gender Imbalance and Competitive Saving



Source: Wei and Zhang (2009)

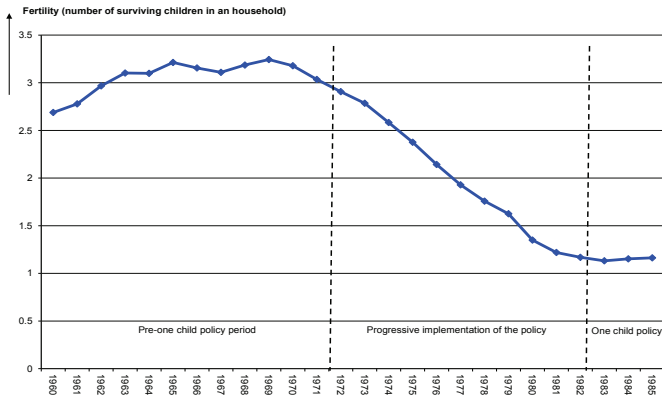
Solution: Outsourcing



Mail-order brides

source: tiboo

Exp. 2: The One Child policy

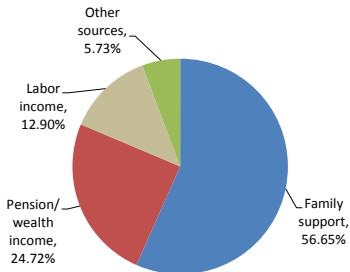


Twin Experiment

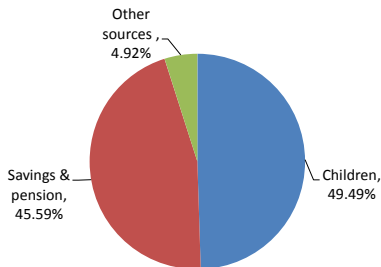
Household Saving Rate	Only Child	Twins	Difference
Average	21.3	12.8	8.5
Income Quintile (low to high)			
1	6.4	-2.9	9.3
2	18.3	16.6	1.7
3	23.7	10.3	13.4
4	27.4	19.5	7.9
5	33.4	25.4	8

source: Choukmhane, Coeurdacier and Jin (2013)

The Transfer Effect



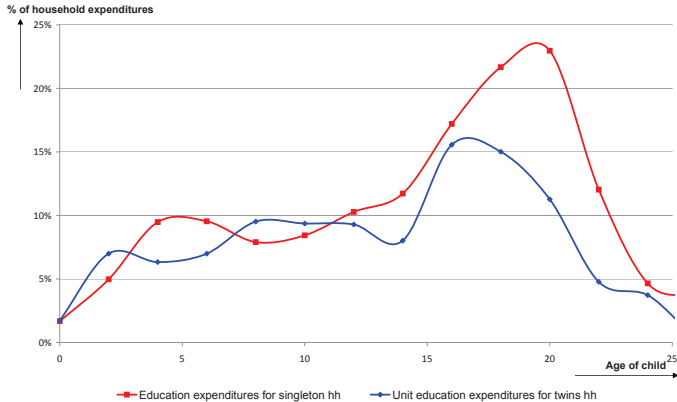
census 2005 - Main source of livelihood (65y+)



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

source: Choukmhane, Coeurdacier and Jin (2013)

One Child Policy By-product



source: Choukmhane, Coeurdacier and Jin (2013)

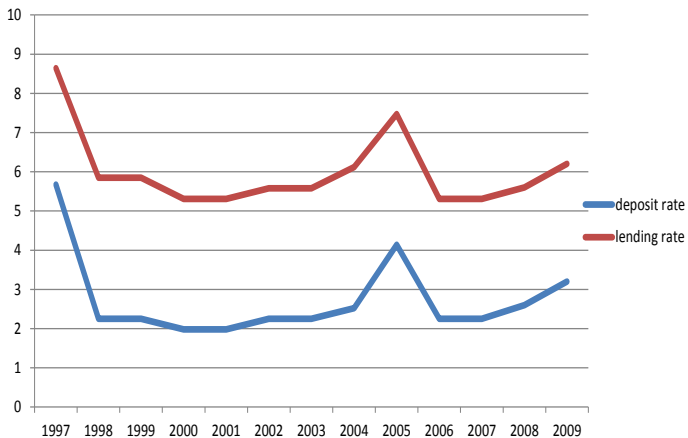
The Human Capital Dividend

- 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

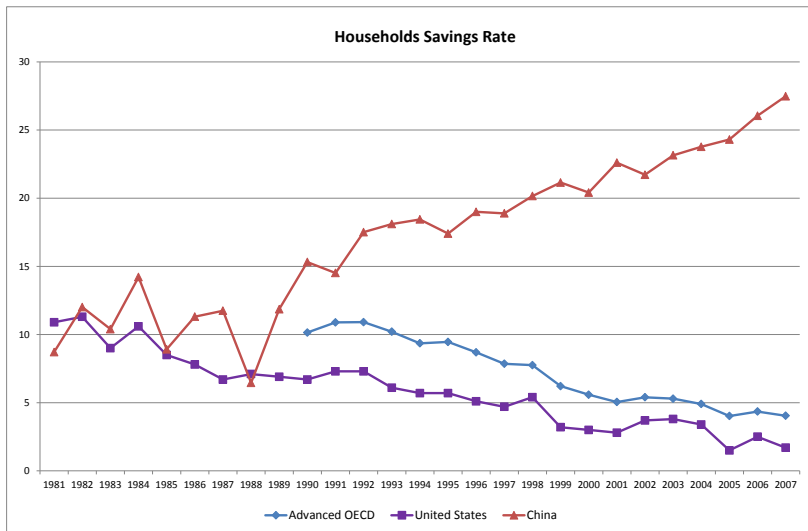
source: author's own calculations

China in the Global Economy

Three Global Facts:

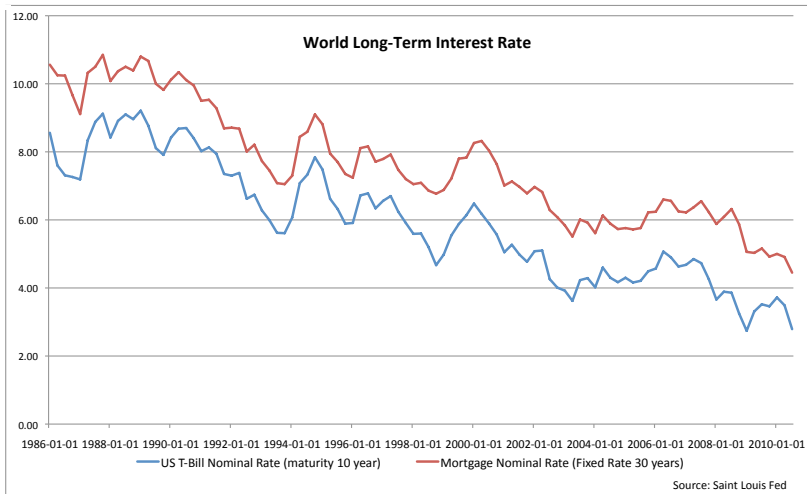
- ① Saving Divergence
- ② Global Imbalances
- ③ Declining interest rates

Figure : The Saving Divergence



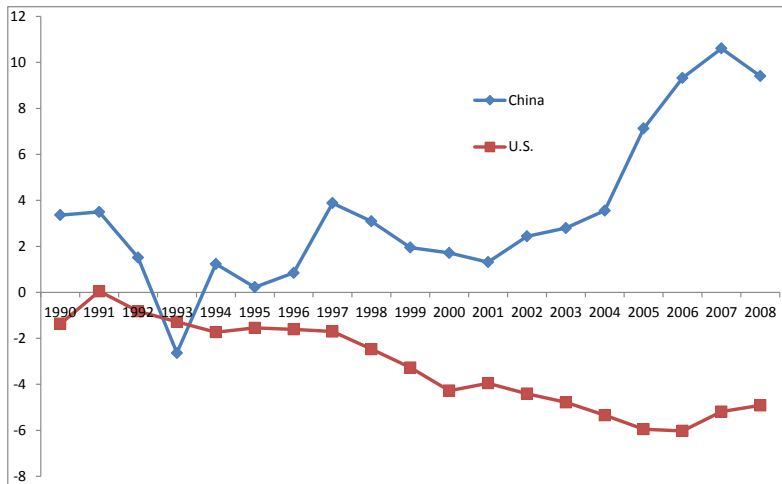
source: Coeurdacier, Guibaud, and Jin (2013)

Figure : Global Interest Rates



source: Coeurdacier, Guibaud, and Jin (2013)

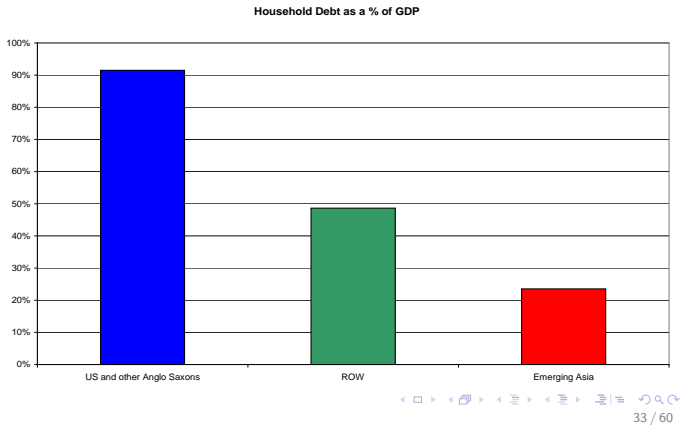
Figure : Global Imbalances



Current Account (% GDP)

source: Coeurdacier, Guibaud, and Jin (2013)

Heterogeneity in household debt



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