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Understanding China's Economic Trajectory

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Financial Crisis Signals

- China has become more important than thought;
- The 30-year Growth Model is not sustainable and fundamental transformation is needed;
- The inward-look mind-set and policies are no longer adaptive to new situation.



Post-crisis Transformation (1/2)

- Shift from export-driven growth to more balanced-growth between international markets and home markets;
- Shift from coastal-dominated growth to more balanced growth between coast and inland-west.



Post-crisis Transformation (2/2)

- Shift from investment-driven and low cost-based growth to innovation-driven and high value added-based growth
- Shift from new entry-dominated growth to growth based on expansion of existing firms through industrial restructuring and M&A.

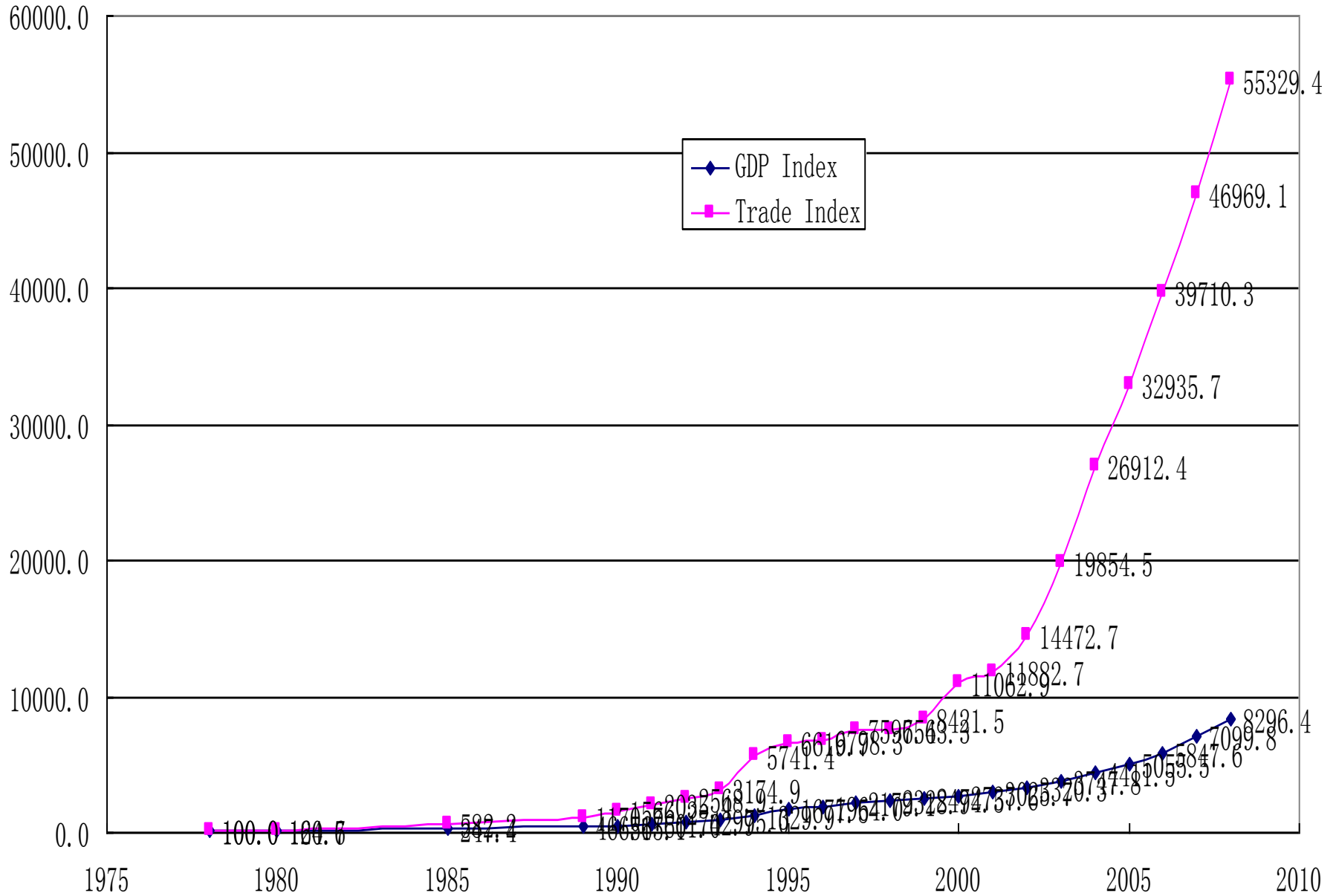


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Imbalance between two markets

- Global market has been well explored;
- Home market is under-explored.

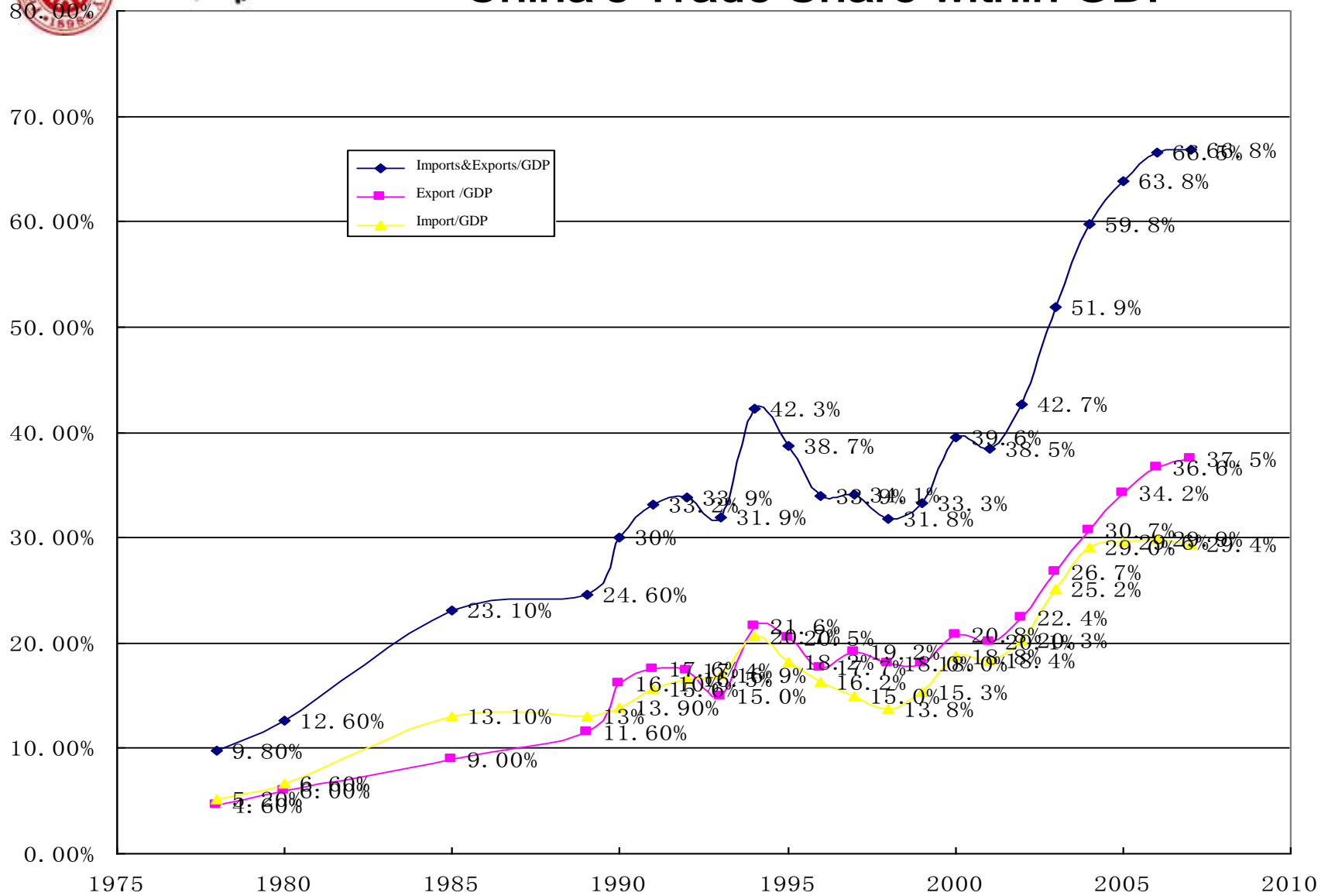




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中国进出口占GDP比率

China's Trade Share within GDP

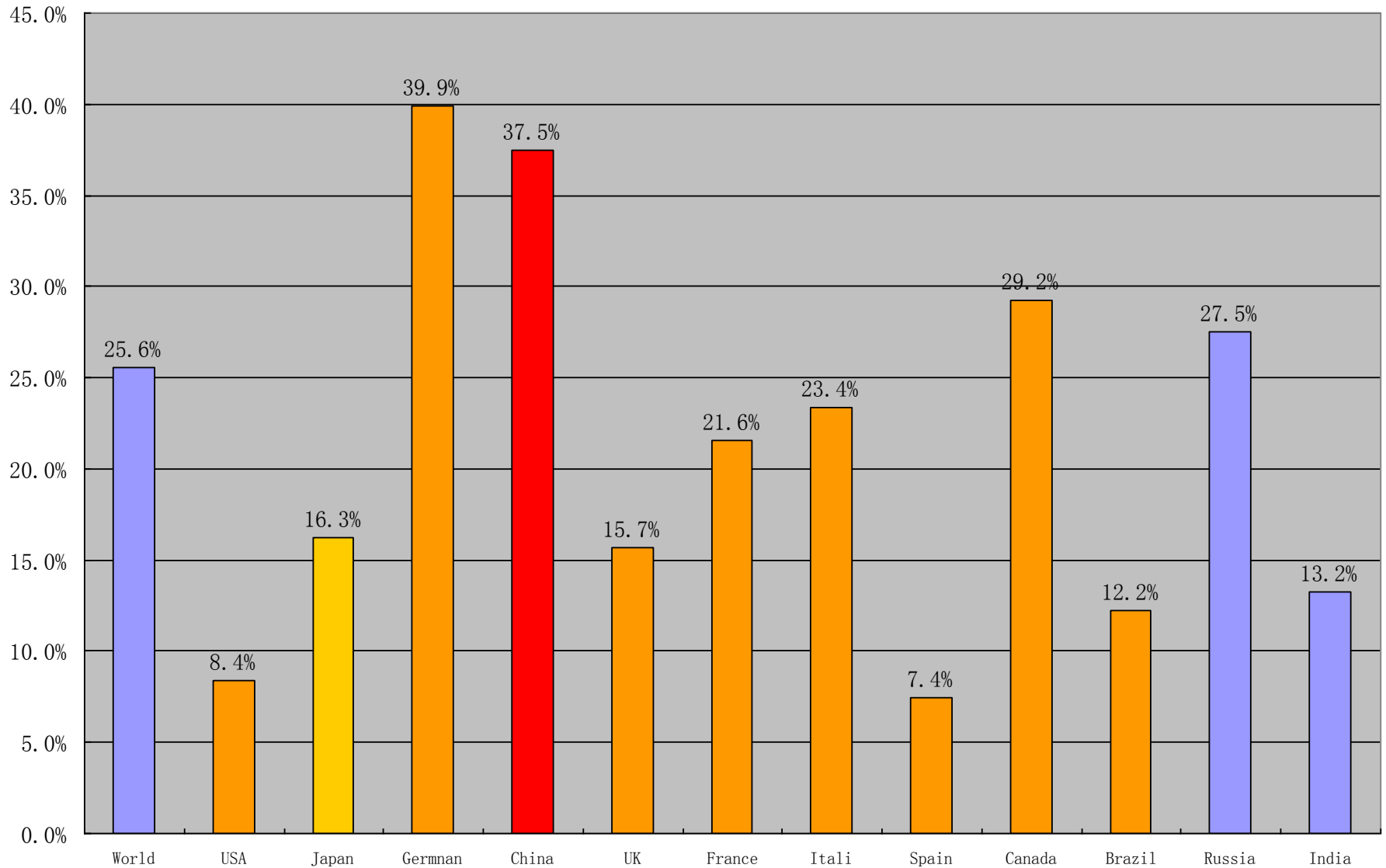




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Export/GDP Ratios (2007, ranked in GDP Size)



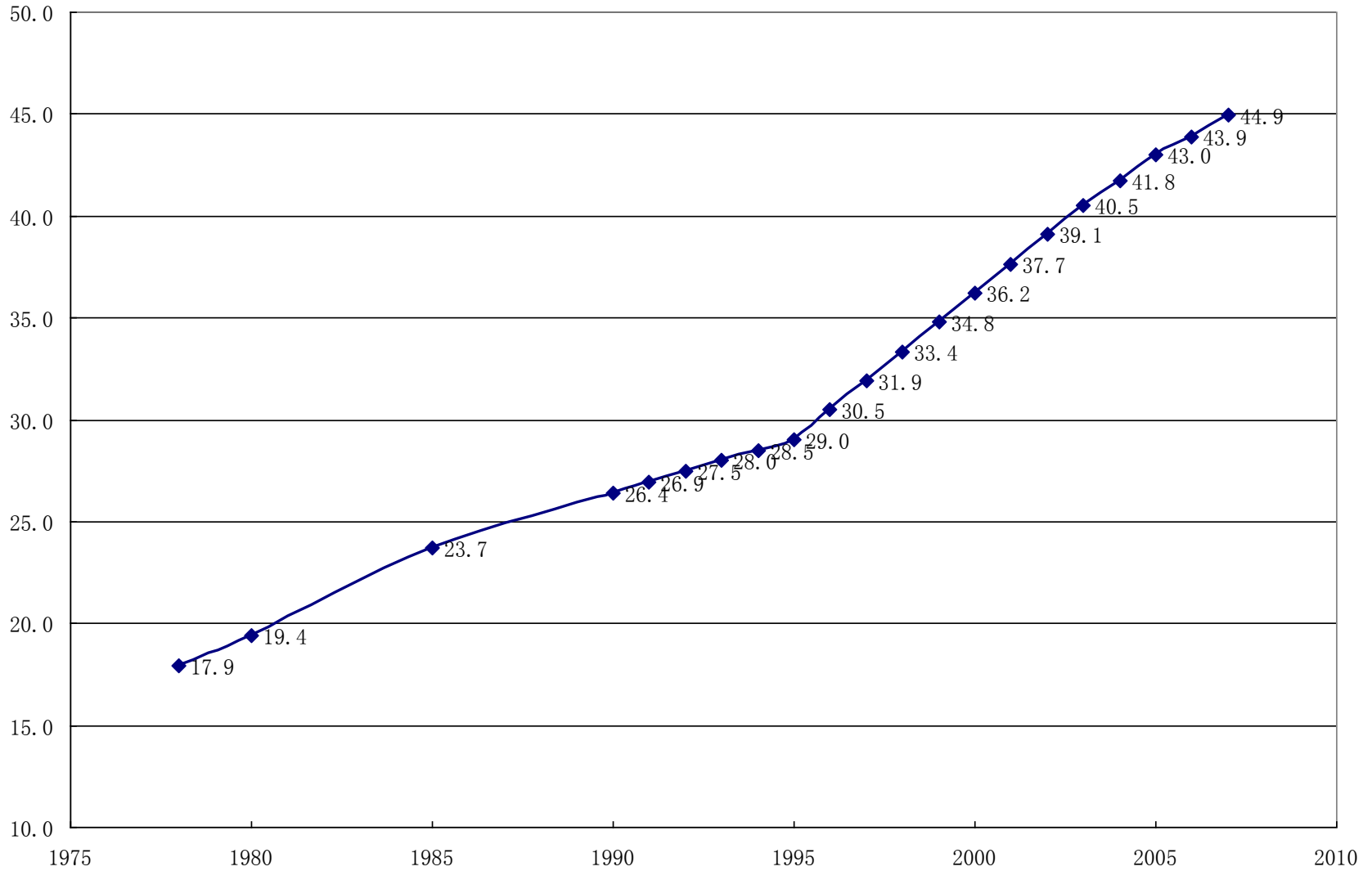


Home Market is Large

- GDP size;
- Population;
- China is a big market for every thing;
 - Foot massage industry;
 - Education;
- Traditional Sectors are profitable;
 - Property markets and PE investment;

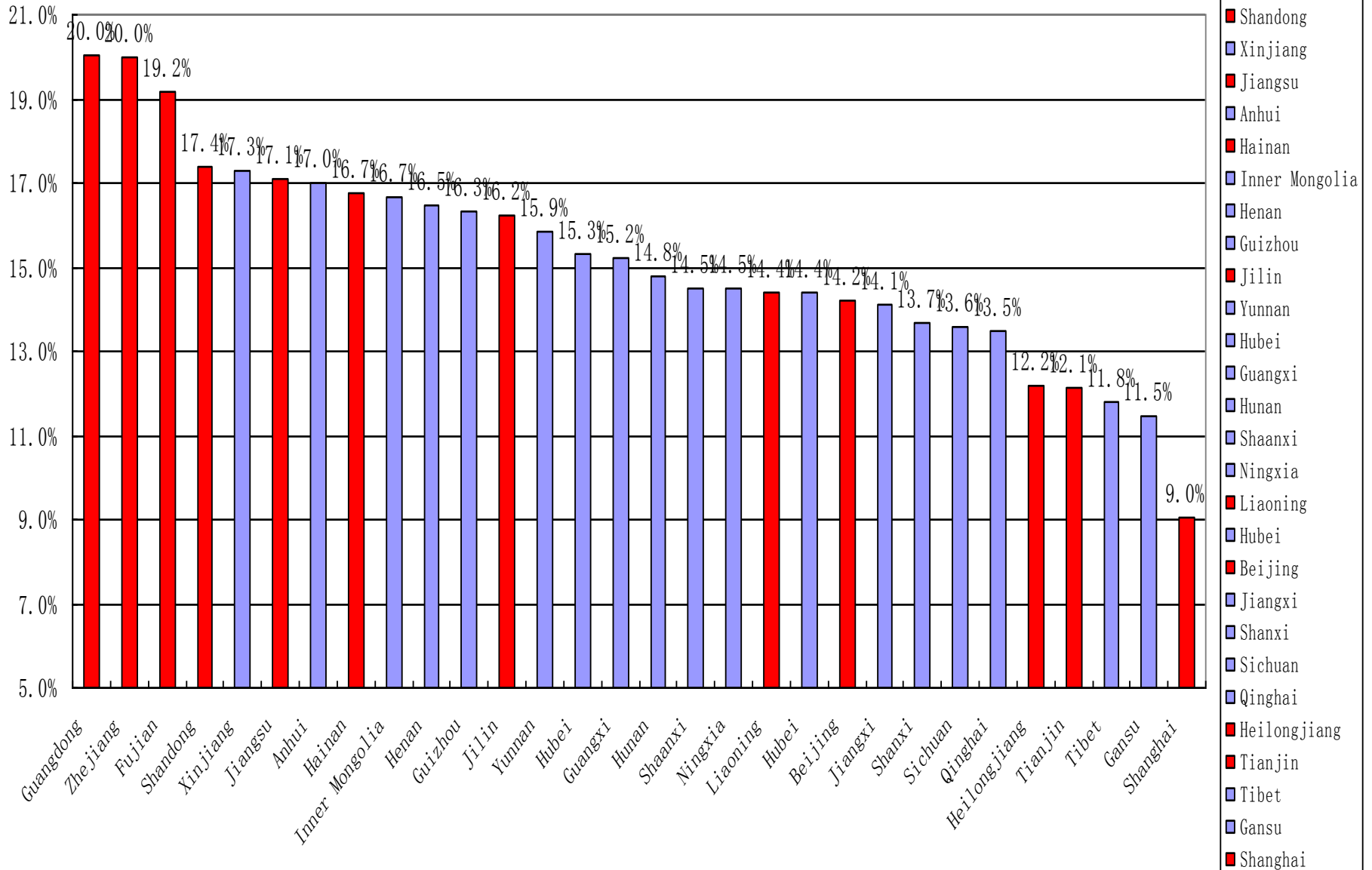


Urbanization (% of Urban Population)



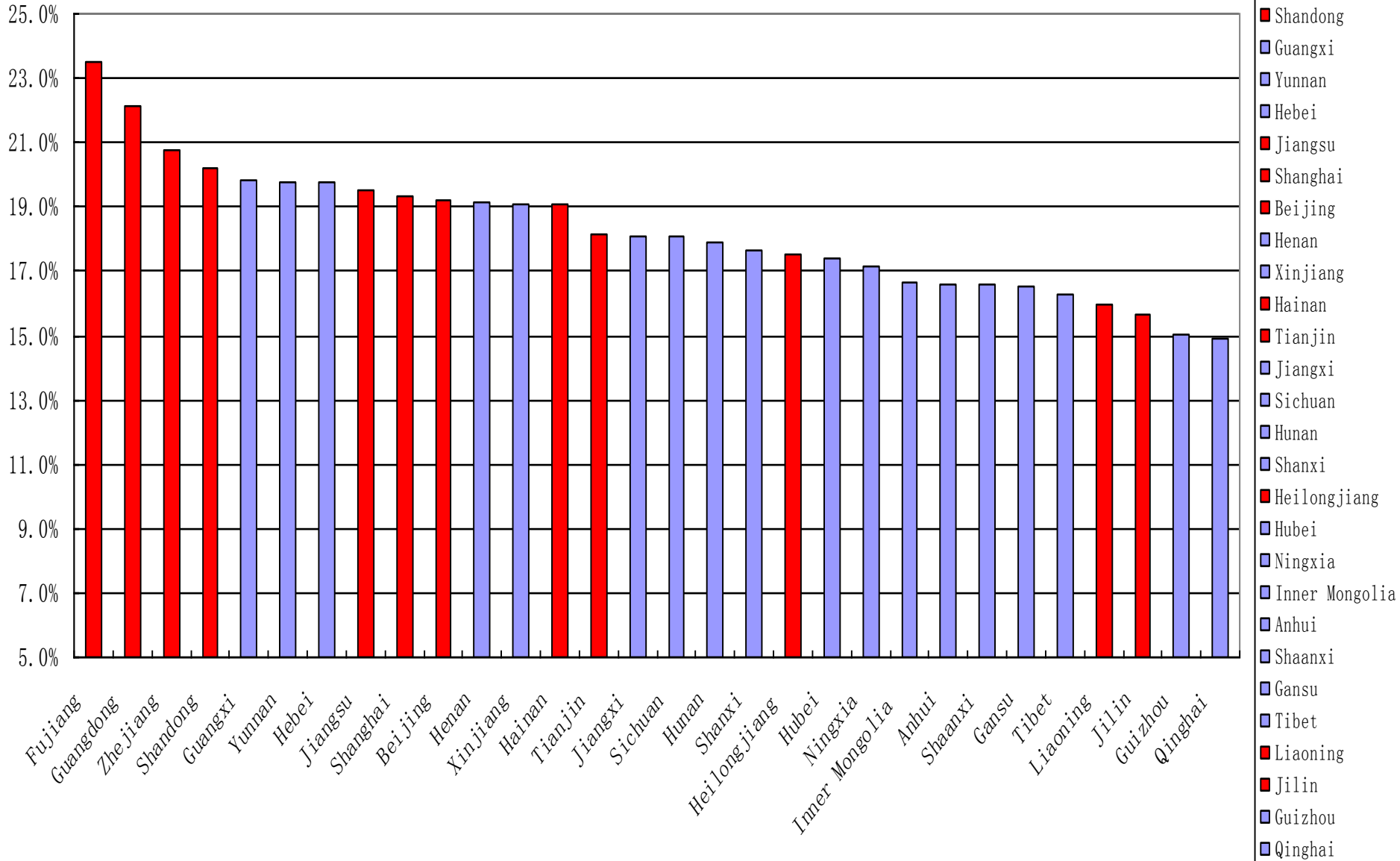


Provincial Growth Comparison (1979-1988; current prices)



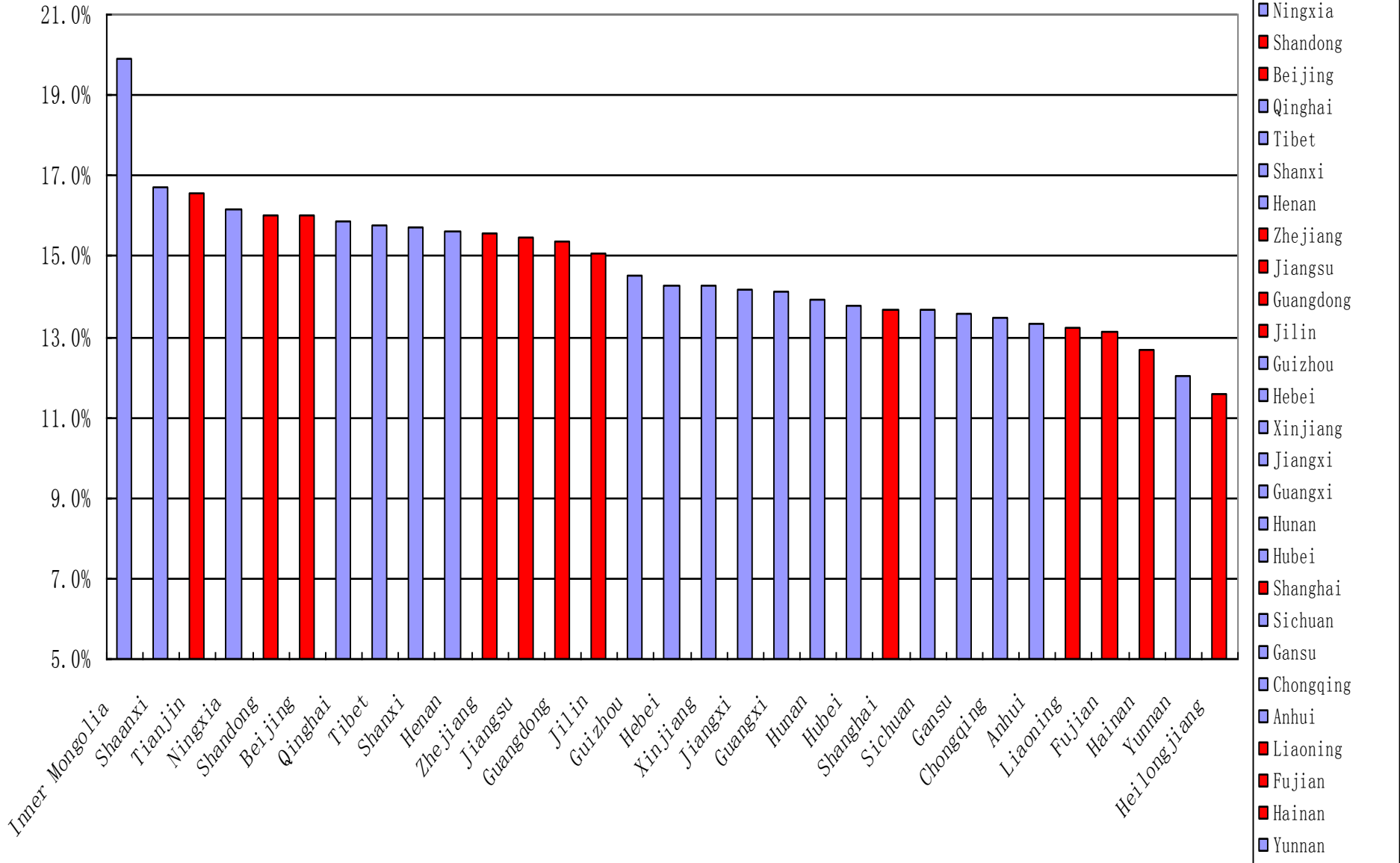


Provincial Growth Comparison (1989-1998; current prices)



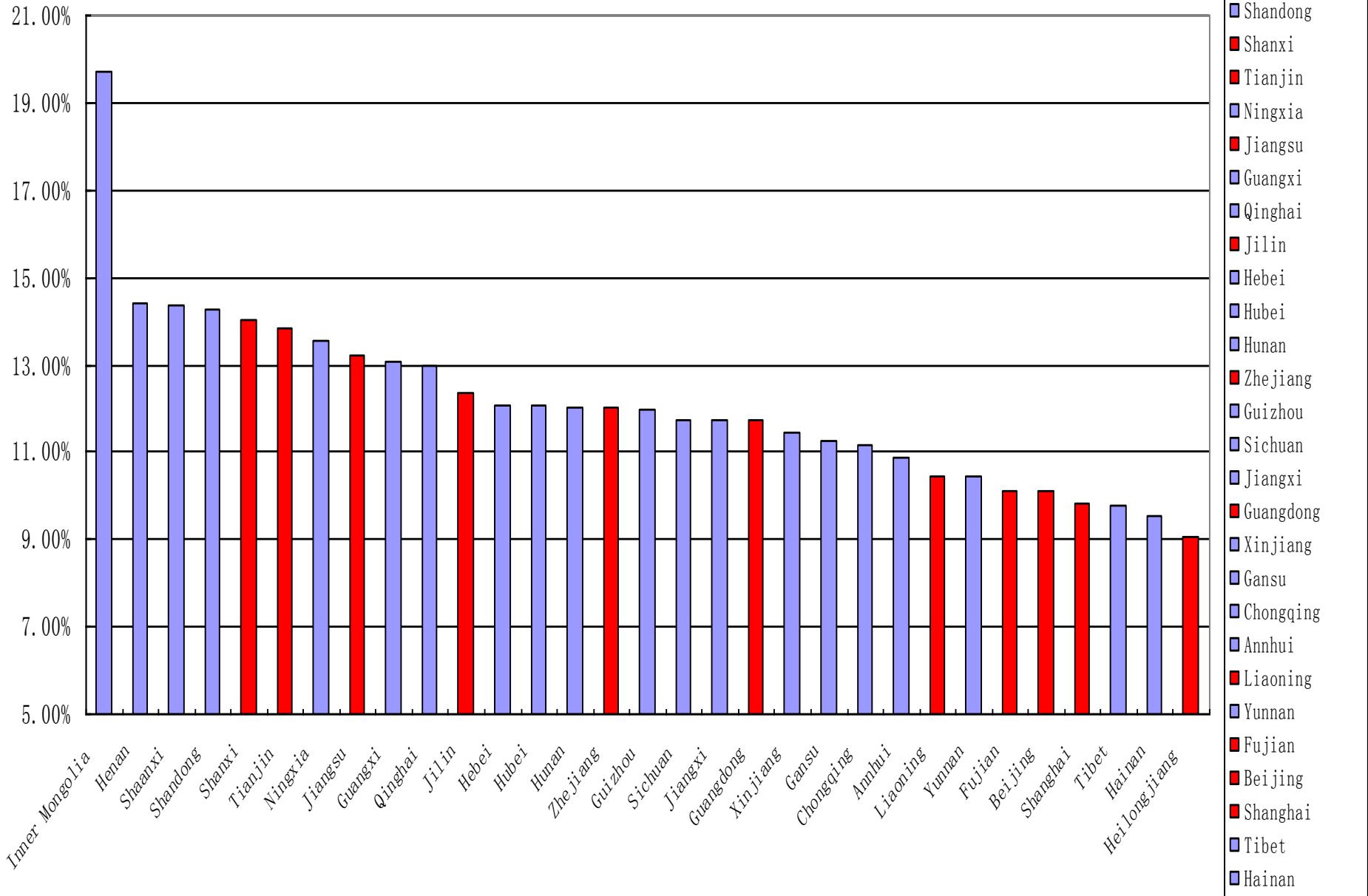


Provincial Growth Comparison (1999-2008; current prices)



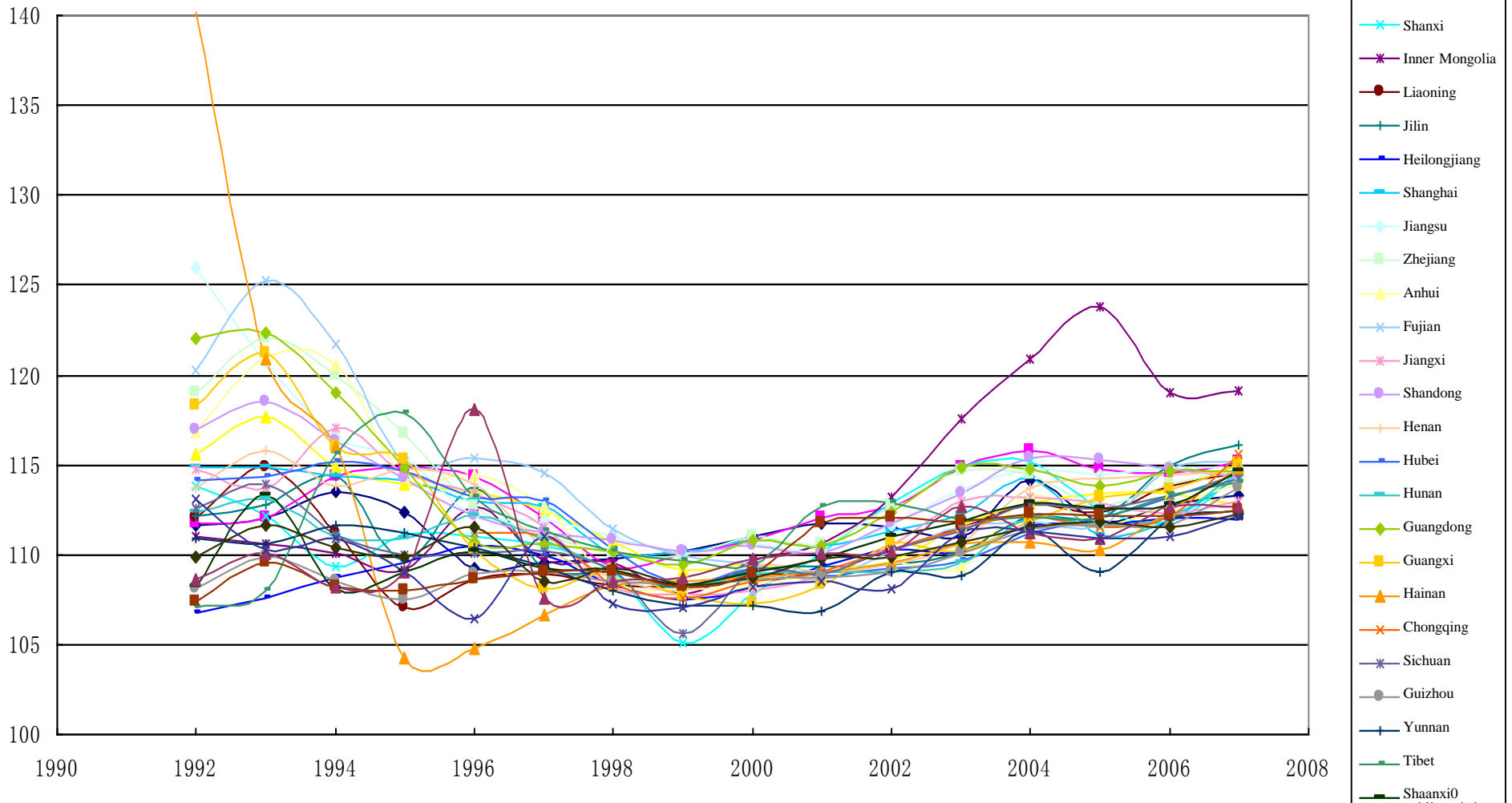


Provincial Growth Comparison (2003-2008; current prices)



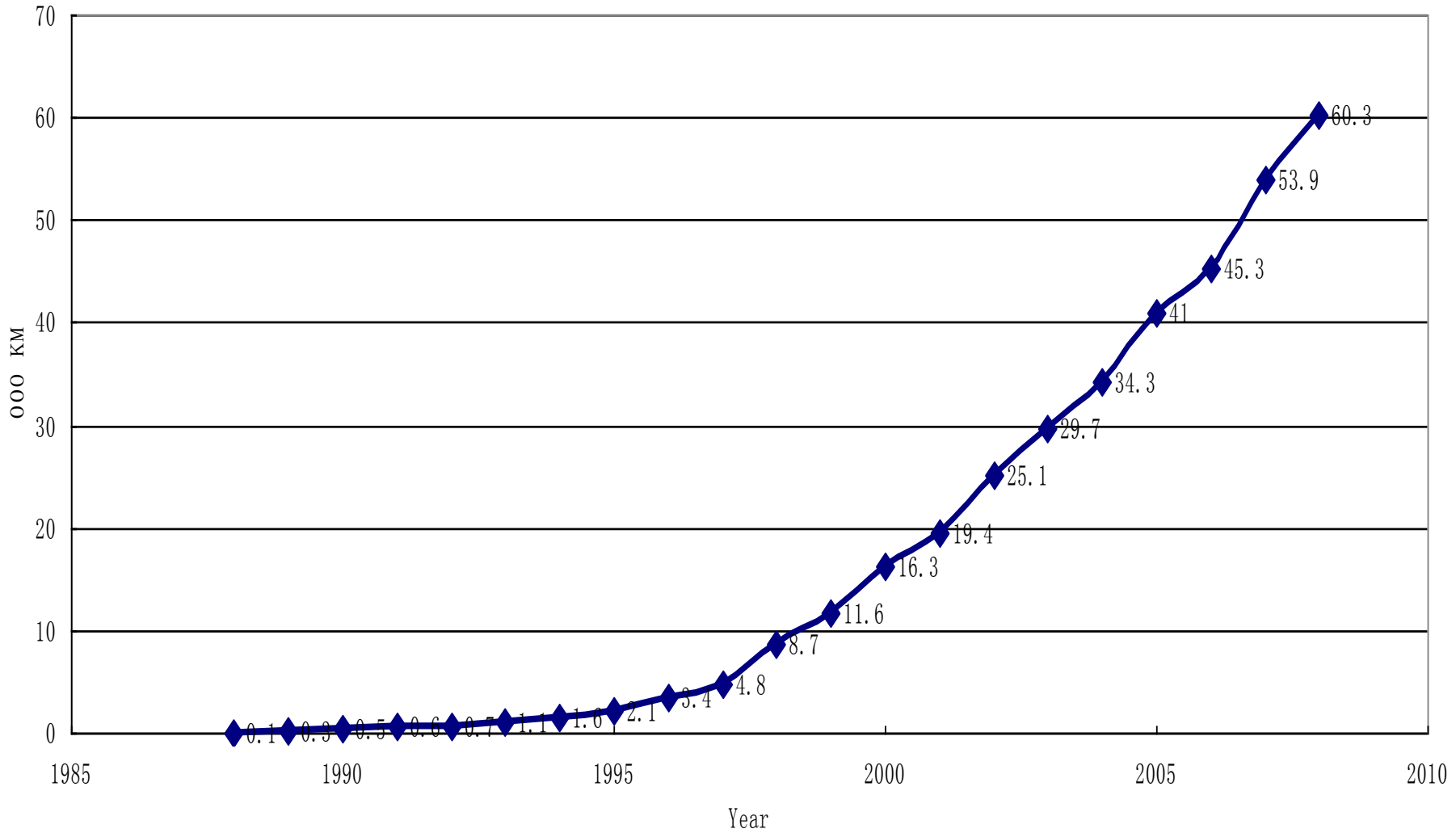


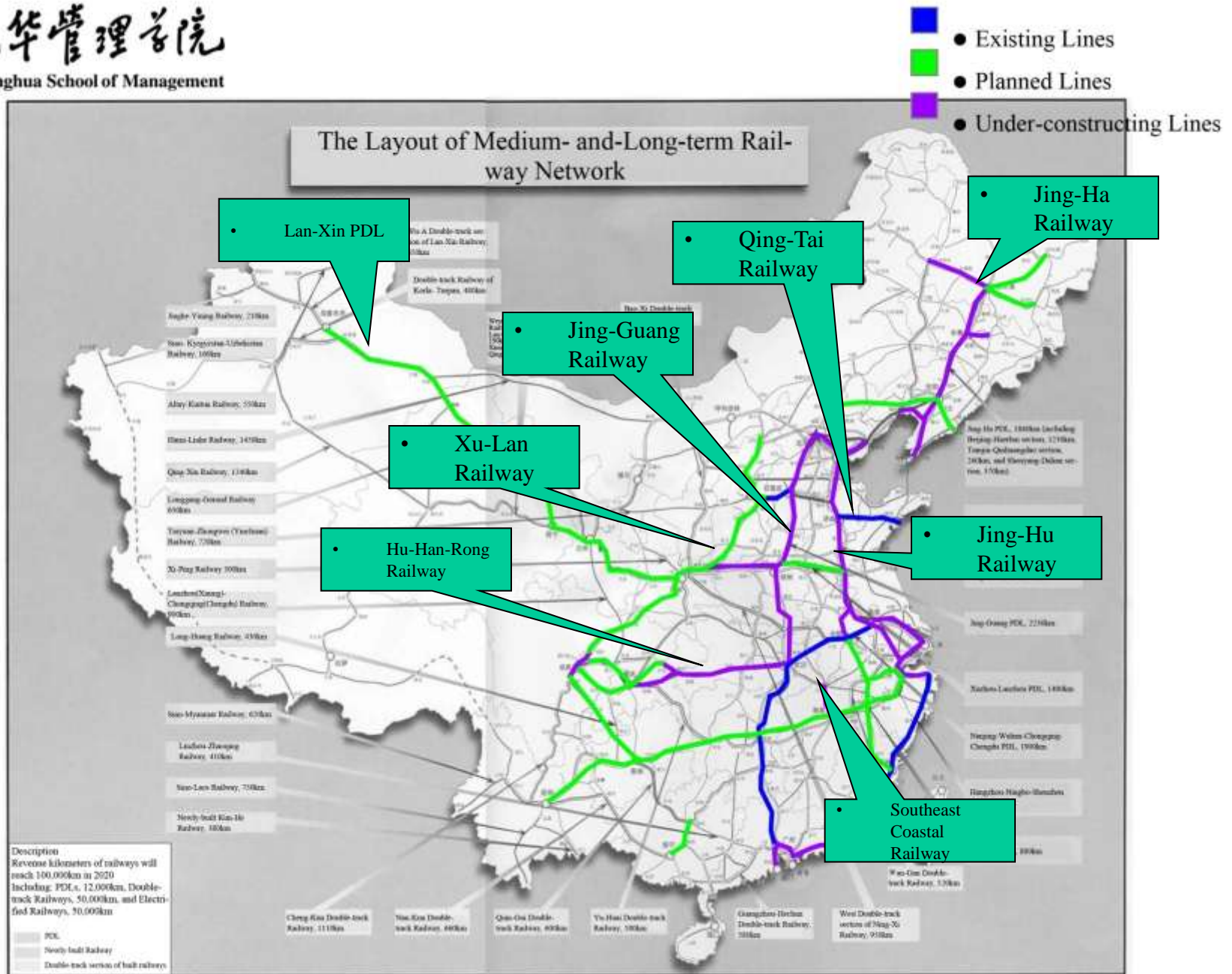
Changes in Growth Pattern (Fixed prices))





China High Way Length 000 km







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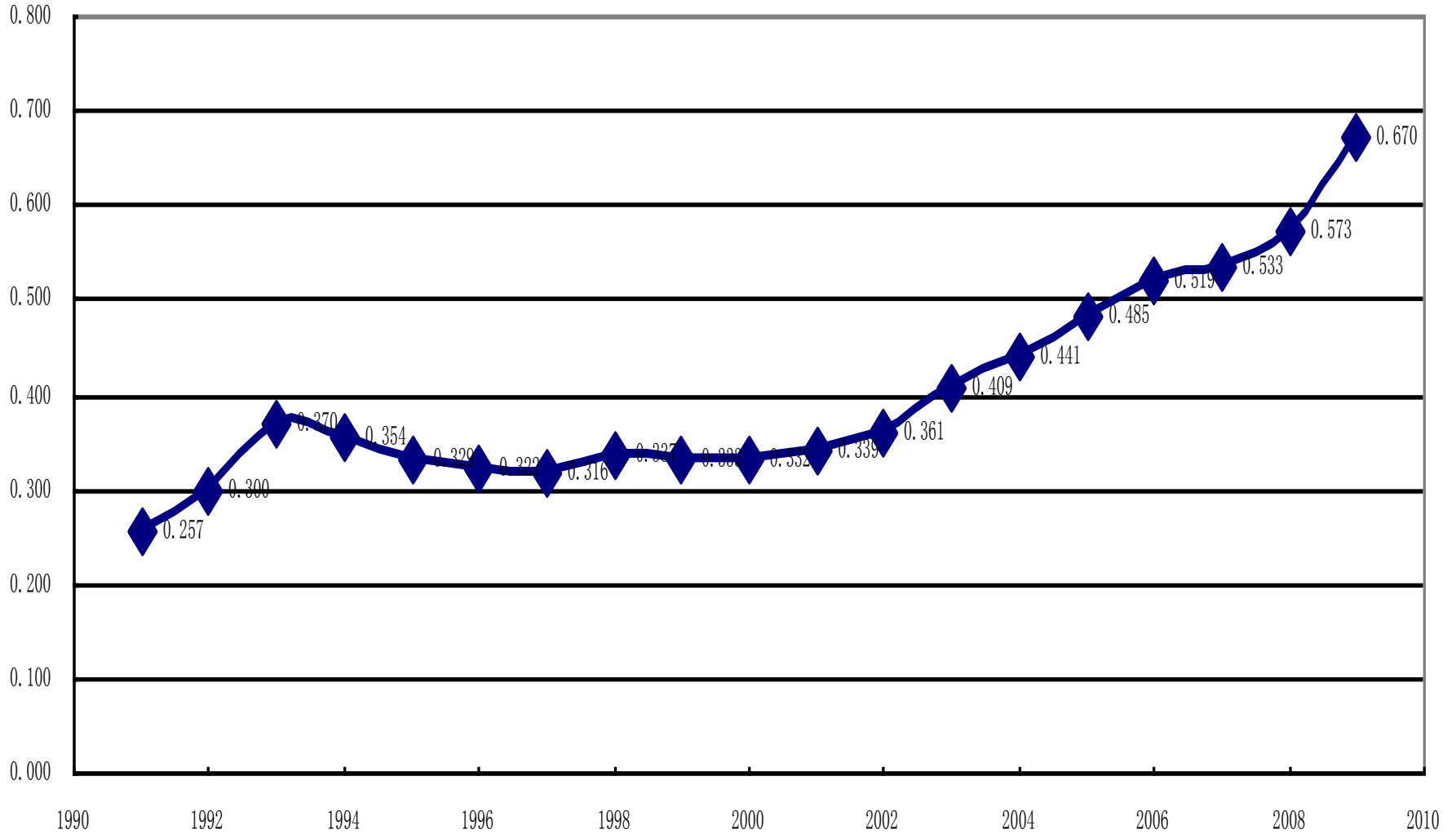
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Innovation and High Value

- Investment-driven growth: hold the tail of a tiger: killed or exhausted to death;
- Demographic change and rising labor cost;

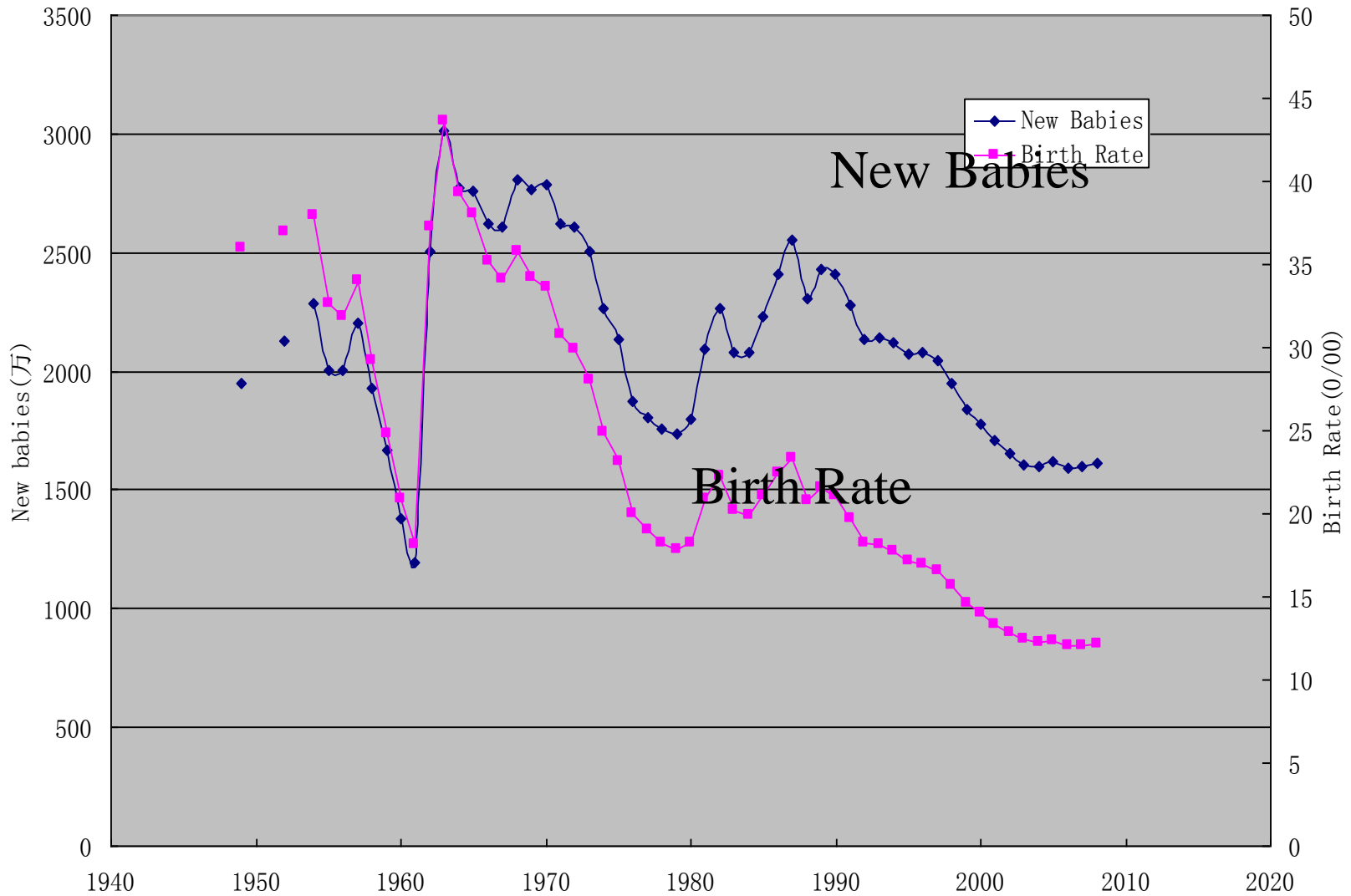


1991-2009全社会固定资产投资占GDP的比率



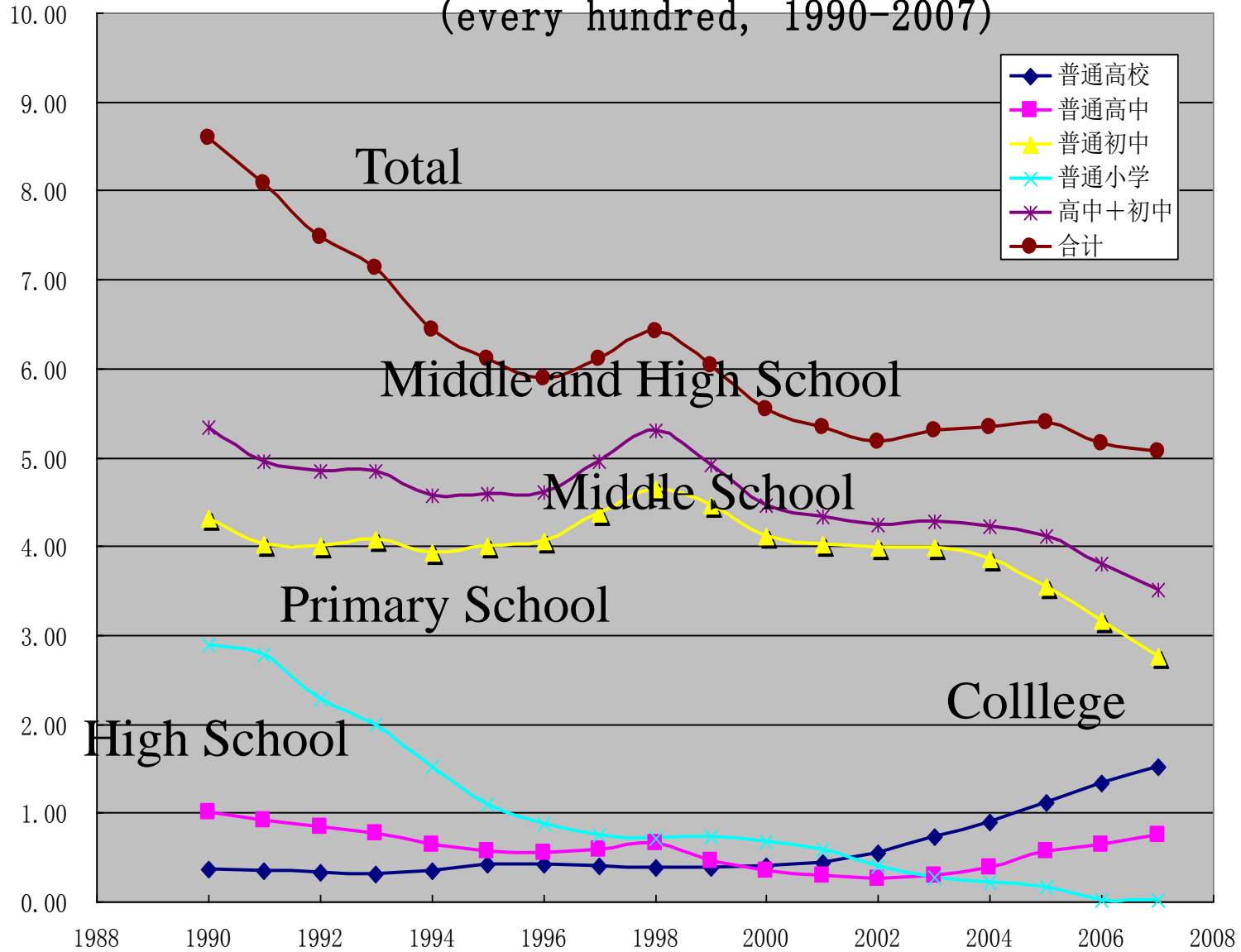


New Babies and Birth Rate (1949-2008)





Ratios of Job demand to Urban Employment
(every hundred, 1990-2007)





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From new entry-driven growth to Industrial Restructuring

- Low Market Concentration Ratio
- Home market M&A;
- Cross-border M&A.



Hurdles to Transition to a New Growth Model

- Transportation cost has been reduced dramatically;
- Transaction Cost remains high.
- Don't mistake development of home market as increasing domestic market.



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Hurdles to Transition to a New Growth Model

- Too big state sector;
- Weak Protection in Property right;
- Divide between Urban and Rural;
- Government-dominance in economy;
- Exchange rate distortion;
- Uncertainty in Political Reform;

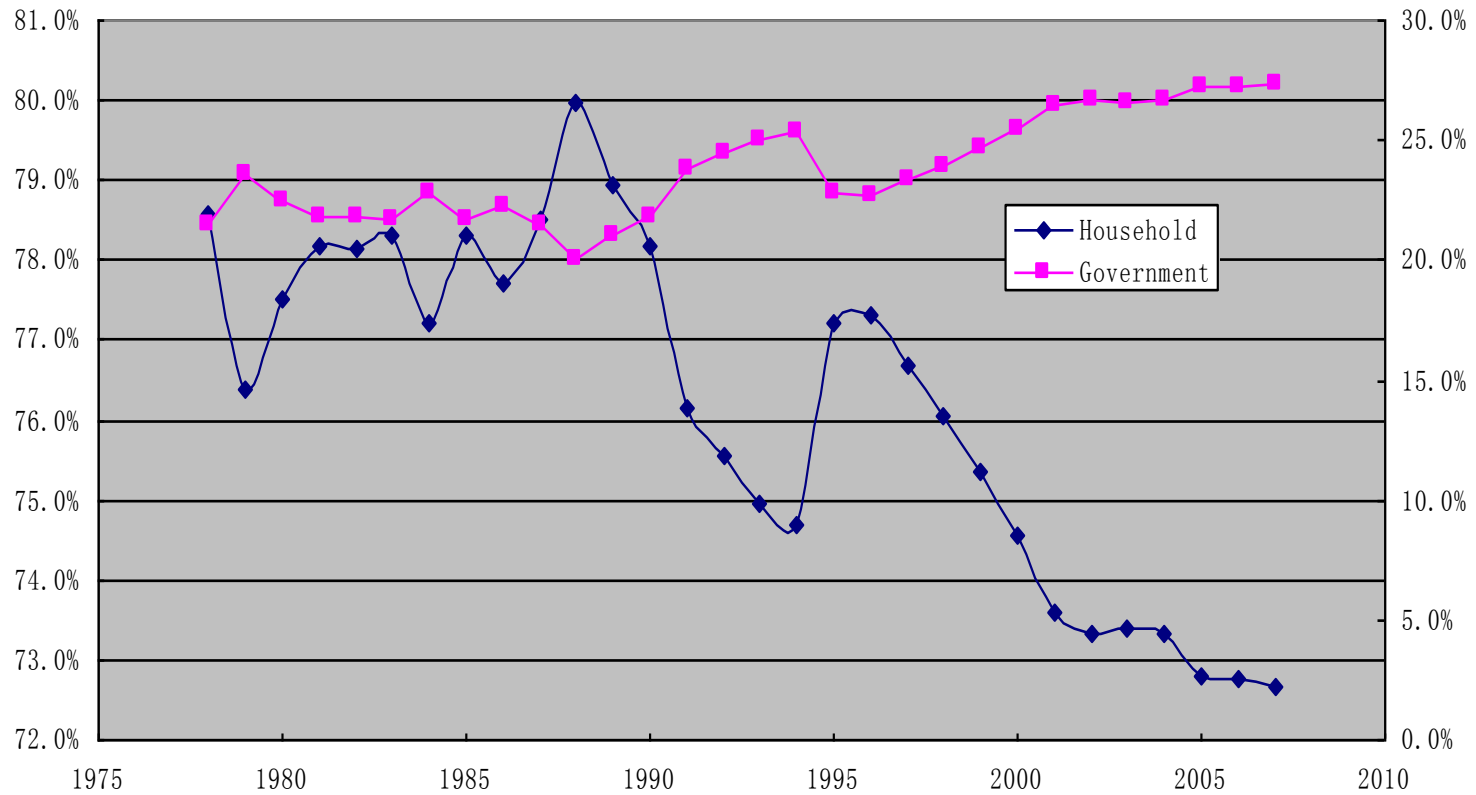


State Sector is Too Big

- Profitable, but not efficient;
 - Profit from monopoly and free resources;
- GDP, but not household income;
- No incentive to innovate;
- Crowd-out of private businesses;



Household Consumption and Government Consumption (%)



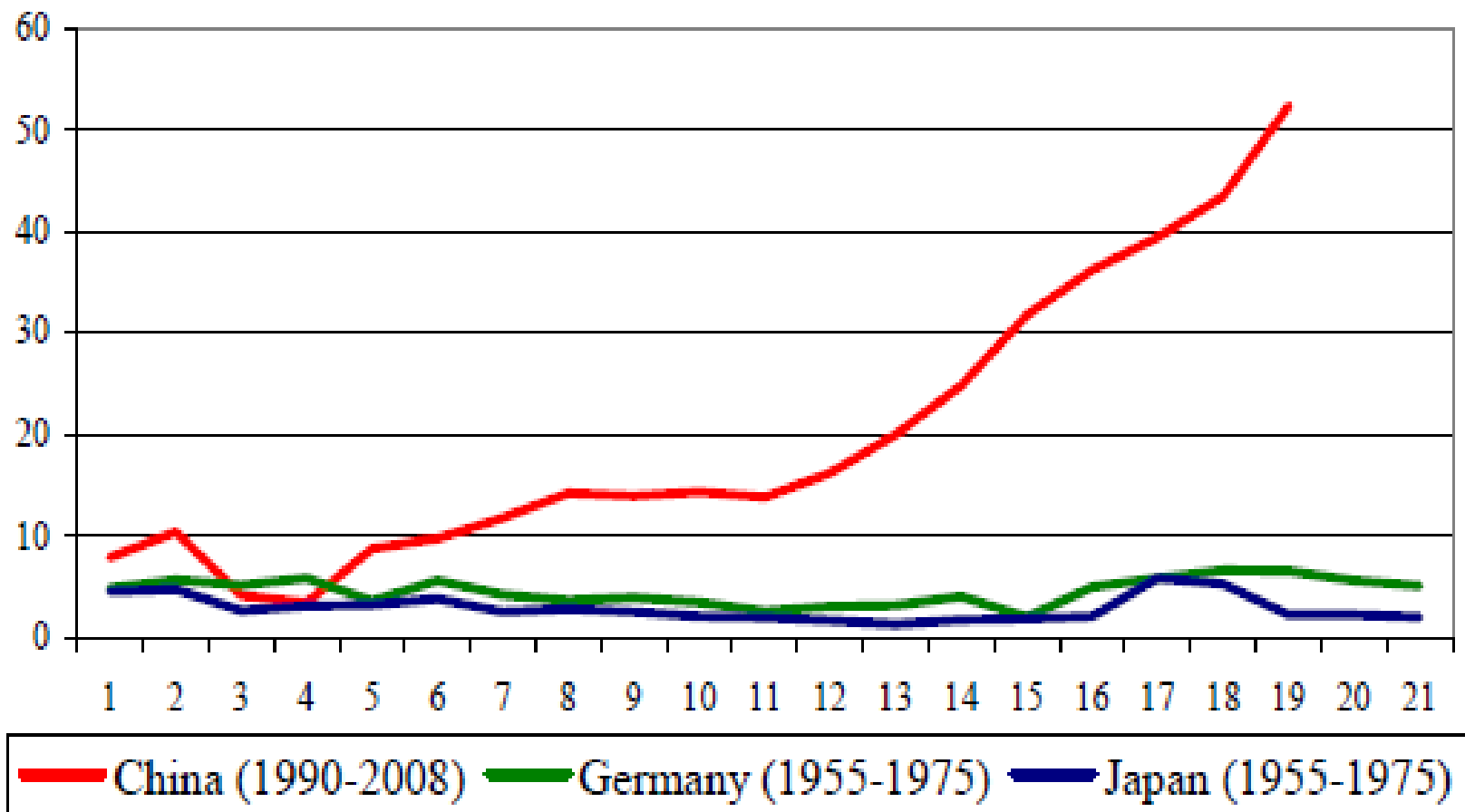
资料来源:中国统计年鉴2008



Exchange Rate of RMB

- Undervalued!
- US is too political and China is too emotional;
- Appreciation benefits China a lot, but not for US economy;
- For China: Appreciation is important for exploring home markets and innovation;
- For US: does not create jobs, but reduce profit of US multi-national companies;

Fig. 2: Foreign currency reserves, per cent of own GDP



Source: IFS



Two Book for US Politicians

- Adam Smith: Wealth of Nations (1776);
 - It is not smart to have a silliness against others' silliness.
- Lao Tzu: Tao Te Ching (道德经) (500 BC)



Tao Te Ching

- Rivers and seas are rulers of the streams of hundreds of valleys, because of the power of their low position;
- If you want to be the ruler of people, you must speak to them like you are their servant; If you want to lead others, you must put their interest ahead of your own.



Tao Te Ching

- A great country should take low place like a great watershed.
- If a great country takes a low position, it will be able to lead small countries;
- Both the large country and small countries will benefit greatly from the large country taking a low position.



Reform in China

- Reform will continue, but not much in near future;
- Reform Momentum:
- In 1980s and 1990s, doing without saying; or talked small but did large;
- Today very different: saying without doing; or talk a lot but do little;
- Like: press gas hard without gearing a car.
- Interest group and politician's risk aversion.

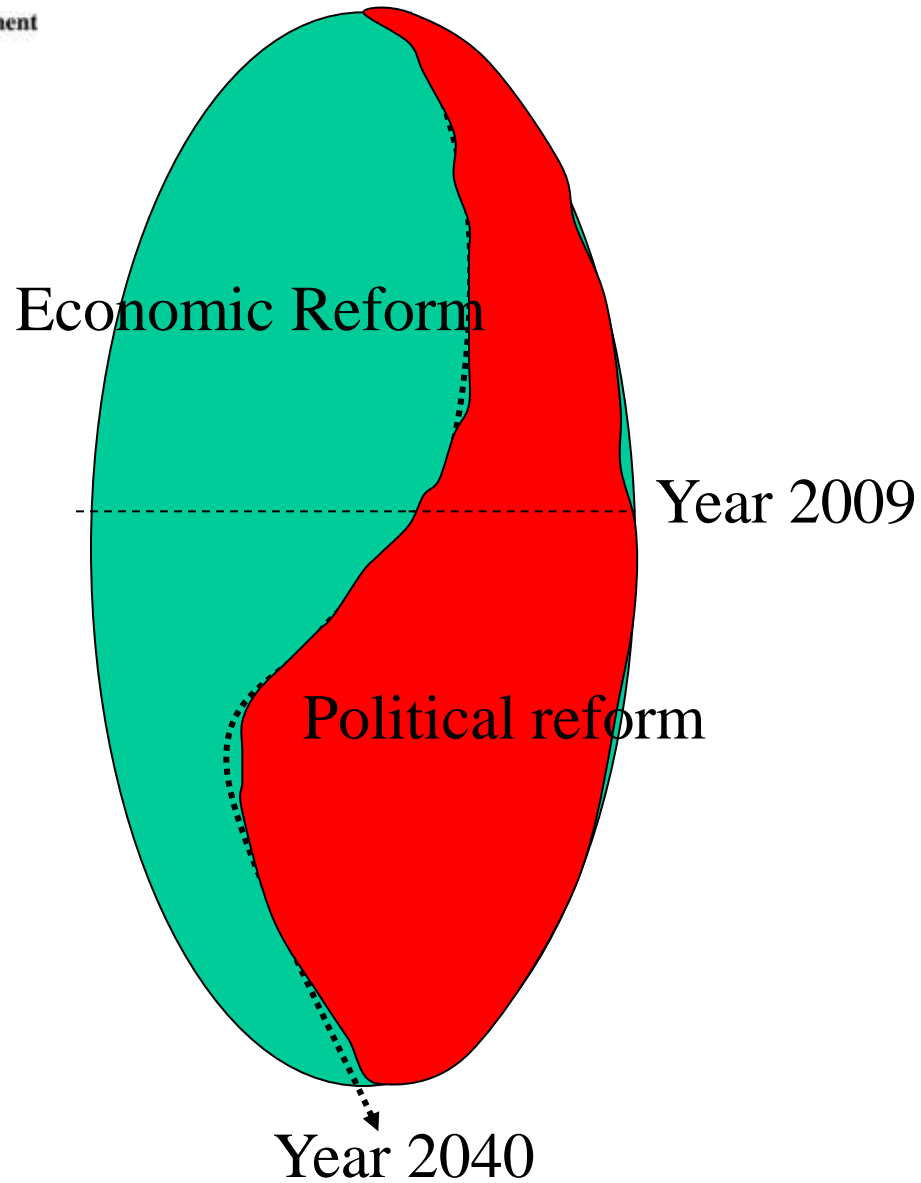


Political Reform

- Lesson from China:
 - Marketization before Democratization.
- But, now it comes that economic reform cannot go ahead without political changes:
- Judicial independence;
- Political reform;
- Challenge; how to combine democracy with elite control?

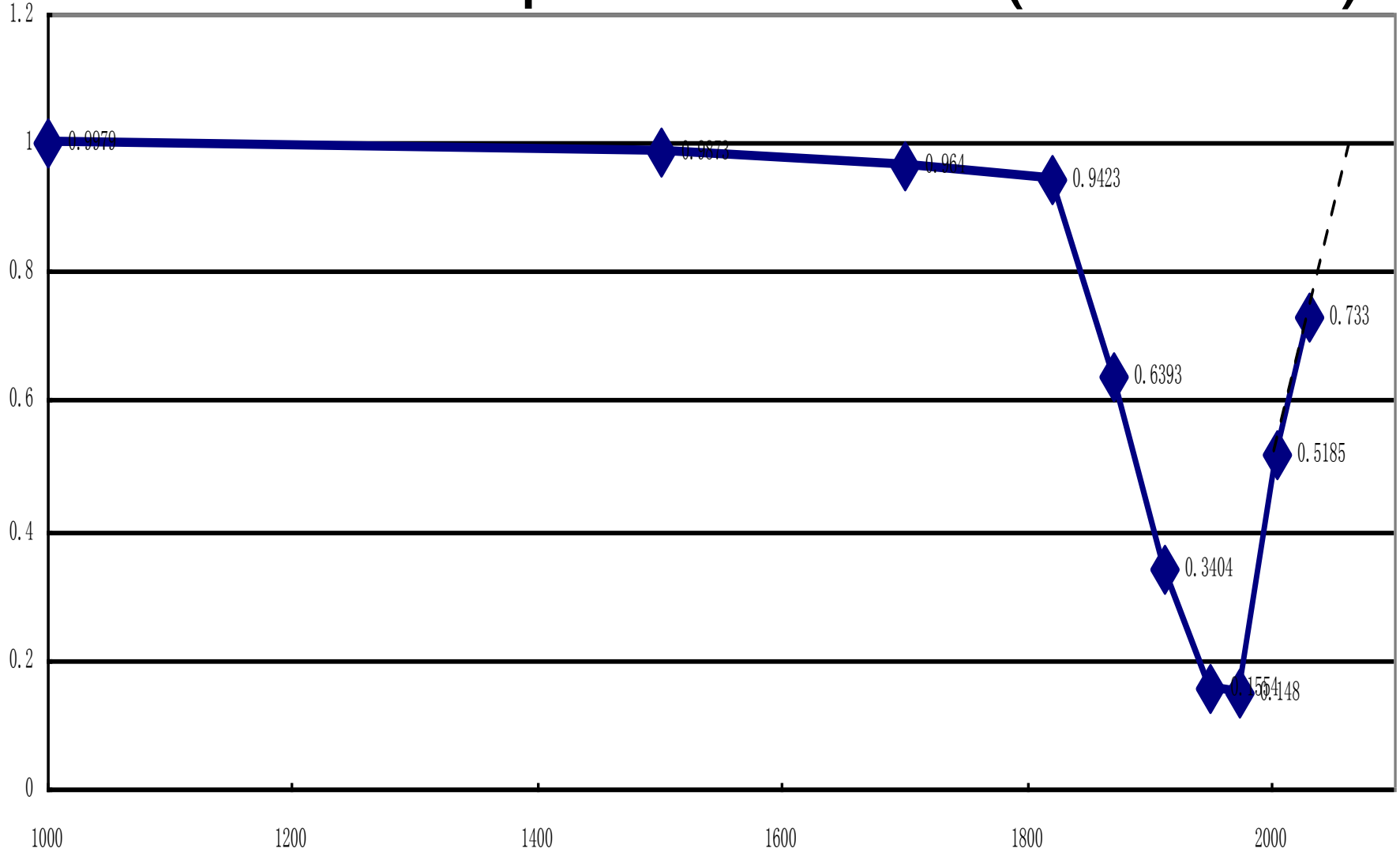


Year 1978





Correlation of Population and GDP (1000 - 2003)





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Thank you!