The Chinese Economy

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The **People’s Republic of China** is currently the second largest economy in the world, with the world’s fastest growth rate and its largest population.
China’s Gross Domestic Product was about 40 trillion Yuan (Renminbi) in 2009, about $6 trillion at official exchange rates, maybe more at purchasing power parity.

USA GDP is about $14 trillion.

Per-capita, USA GDP is about $45,000 and China’s about $4,500, so they still have a long way to go to catch up.

At an annual real per-capita growth rate of 9% over the last decade, China is trying.
China’s future?

If China and the USA maintain current growth rates (assuming they are accurate), China will be the world biggest economy in a dozen years, and will catch up to the USA in per-capita terms in 30 years.

But these growth rates cannot be maintained forever. Smaller economies grow faster due to the catch-up effect. After this decade, the USA cannot possibly continue to import as much as China will have to export.
China is also an economy still in transition from a poor, rural command economy to a dynamic and prosperous market economy, with a stark contrast between a large and mostly poor rural population, and relatively advanced, westernized, and wealthy cities.
Population Density

- China has significantly less farmable land than the USA, so the density per unit of arable land is almost nine times that of the USA.
- Rapid Chinese growth requires that it transition from agriculture to labor-intensive industry.
- China is also spending enormous amounts for public and private investment. (40% vs. 15% average for USA).
Geography and Population

- China’s population is 1.3 billion people (currently growing at only 0.5% per year).
- Roughly half of Chinese still live in rural areas, and most of the people in the east.
- China used to be 90% rural. This is one of the largest human migrations ever.
China’s land area is roughly 3.7 million square miles, compared to 3.5 for the USA (including 0.6 in Alaska). The U.S. is bigger if you include water (the Great Lakes).

China’s average population density is more than four times that of the USA.
China is mostly mountains and deserts
So where do Chinese live?
China is the longest continuous civilization in the world

- More than 3000 years of recorded history.
- Until 1750 or so, China was more advanced country than any in the West.
- Ancient Chinese invented many things before the West, including the compass, papermaking, printing, gunpowder, the shadow clock, the abacus, the seismometer, and the crossbow.
- In the 1200s, China produced much more pig iron than England did in the 1700s. They used natural gas for fuel, and could deep mine.
- They also invented the iron plow, the propeller, the suspension bridge, the parachute, the seed drill, and the double-action piston pump.
China has long used its land intensively
Centuries ago, China pushed the production limits of premodern agriculture.
Long Tradition of Living in, and also Abusing Nature
China Before Mao

- China was able to feed and maintain a large population for many centuries, through many imperial dynasties.
- China was dominated by Mongols in 1300s, by Manchus in 18th-19th Centuries, by European nations from 1840s – 1940s, and by Japan from 1937-1945.
- Overpopulation and economic decline began just as European nations began to take off.
China under Chairman MAO Zedong

- Civil War between Communists and Nationalists after WWII. Nationalists fled to Taiwan.
- October 1, 1949: People’s Republic of China founded by Chairman Mao.
- PRC not recognized by USA until 1970s, was very isolated from the rest of the world.
- China fought the USA to a standstill in the Korean War.
Commmunist China

- Mao led the communist party, and they tried to create a socialist economy like the Soviet Union.
- Soviet-style nationalization of industry in 1950s, where the government owns and controls all firms.
- Gradual collectivization of agriculture, so people farmed in large groups. Equal sharing, but very little incentive.
- Great Leap Forward (1958-60) led to world’s worst famine: 30-50 million died.
The Cultural Revolution

- 1966-69, -76.
- Started with criticism of a playwright.
- Red Guards and attack on Four Olds: old customs, old culture, old habits, old ideas.
- Universities, schools, factories, much of China shut down, torn apart.
Much damage was done.
DENG Xiaoping

- Mao died in 1976.
- DENG Xiaoping emerged as “paramount leader” in 1978 after his followers were elected to the highest positions.
- He ended “Politics in Command,” and replaced it with pragmatic “black cat, white cat” approach.
- He changed the rules to make sure no other leader could have Mao’s power again.
- Chinese Communist Party (CCP) repudiated Mao’s policies without repudiating Mao.
Deng’s Economic Reforms

- **Open Door Policy**: China was opened up to foreign visitors, foreign investors, and foreign trade.

- **Rural Reform**: Land was allocated to families instead of to big groups called communes. Rural towns and villages could invest in and produce manufactured goods.

- **Industrial Reform**: State-owned firms were reformed in an effort to make them more efficient. They became more productive, but also were able to get more investment than they could productively use, while more competition and poor management led to falling profits for the state.
Under President JIANG Zemin, the CCP renounced the idea that economic reform was just a temporary stage. Instead, the new policy was to create a developed market economy with the CCP in charge. State firms would be the “cornerstone” but not necessarily the dominant type of firm.

New types of firms – including foreign-owned and private Chinese-owned – were encouraged.

By the end of the 1990s, private entrepreneurs would be allowed into the communist party.
China’s Changing Industrial Structure

- New Chinese private firms, wholly-owned foreign firms allowed, but these have little access to bank loans or the stock market.
- Policy of “release the small, retain the large” for state firms, leading to huge layoffs in 1990s and creating large Korean-style firms.
- Export sector dominated by rural firms, foreign-owned firms, and private firms; relied upon to deal with urban unemployment problem.
Rural China

- Most Chinese still live in rural areas, on less than $2 per day.
- Rural areas continue to have large surplus labor problem, and many worry about effect of U.S. agricultural imports on farm prices.
- Reports of many protests by farmers over extractive rural leaders.
- Recent experiments in local elections.
- Widening poverty gap between rural and urban areas.
Education

- Literacy rate is roughly 90%.
- China has more than 30 million new high school graduates per year, plus 2.4 million traditional college graduates, 1.9 million returning adult graduates, and 150,000 advanced graduates.
- The most popular majors for advanced graduate study are engineering, management, science, medicine, and law.
- China’s exports have typically been concentrated in labor-intensive products that used to be produced by other Asian countries, but China is starting to move into more higher-tech areas.
- China’s government is making a major investment in its universities, attracting back professors from top-ranked schools in USA and elsewhere. Qinghua, et cetera.
China is run by the Chinese Communist Party. Provincial/municipal governments are appointed by the central administration.

Chief of State is President HU Jintao, who is also General Secretary of the Chinese Communist Party. The President is appointed by the National People’s Congress to up to two five-year terms.

Head of government is Premier WEN Jiabao, also appointed by the NPC, together with the entire State Council.

China’s appointed leaders are all members of the CCP, as are most representatives to the NPC.
China’s Foreign Trade and Investment

- China has gone from a closed economy to the world’s largest exporter, and its second largest importer.
- China buys 7% of USA exports, after the EU, Canada, and Mexico, and followed by Japan.
- China supplied 19% of USA imports, followed by the EU, Canada, Mexico, and Japan. The majority of these imports are from USA-invested firms.
### Leading Trading Nations, 2009

<table>
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<th>Country</th>
<th>Exports</th>
<th>Share</th>
<th>Chg</th>
<th>Country</th>
<th>Imports</th>
<th>Share</th>
<th>Chg</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>1,202</td>
<td>9.6%</td>
<td>-16</td>
<td>USA</td>
<td>1,605</td>
<td>12.7%</td>
<td>-26</td>
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<tr>
<td>Germany</td>
<td>1,126</td>
<td>9.0%</td>
<td>-22</td>
<td>China</td>
<td>1,006</td>
<td>7.9%</td>
<td>-11</td>
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<tr>
<td>USA</td>
<td>1,056</td>
<td>8.5%</td>
<td>-18</td>
<td>Germany</td>
<td>938</td>
<td>7.4%</td>
<td>-21</td>
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<tr>
<td>Japan</td>
<td>581</td>
<td>4.6%</td>
<td>-26</td>
<td>France</td>
<td>560</td>
<td>4.4%</td>
<td>-22</td>
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- China’s trade surplus is mostly with the USA. It runs a deficit with the rest of the world.
- China’s trade surplus has been narrowing recently.
By 2006, China was receiving over $70 billion in Foreign Direct Investment per year. China is the largest recipient of FDI in the less developed world.

It was also technically the largest recipient in the world, but this amount included amounts from Hong Kong.

After HK, the USA is the largest investor in China.
China’s urban landscape has been suddenly transformed.
Not always for the best...
China’s Banking

- China has four major state-owned banks: BOC, CBC, ICBC, and ABC. Some are foreign-invested. (PBC is the central bank.)
- These banks still have considerable NPL problems from past loans to state enterprises, but implicit government guarantees.
- There are also smaller foreign-owned, private, and city banks, plus some state-owned investment trust companies.
- There is an implicit insurance from expectation Yuan will rise in future.
China’s Stock Markets

- Since 1990s, China has had stock markets (Shenzhen and Shanghai) for shares of partial ownership in state firms and some new private firms.
- Foreigners were segregated into a “B Shares” market so buying stock did not first require conversion into the Yuan. These rules have eased in recent years.
- With high savings and low interest rates, Chinese look for places to get a better return. This has led to bubbles in the stock market, as the demand for stocks increased stock prices, increasing the demand for stocks.
- From January to October 2008, the SSE Index fell 70%.
In 2008, the SSE lost 70% of its value!
What about the Chinese Currency?

- Before 1994 Devaluation: inefficient state enterprises, massive NPL problem in state banks, overvalued RMB.
- In 1994, RMB value fell by half – to match black market rates. Inflation in 1990s raised effective real rate.
- Chinese currency had “airlock” system to limit convertibility, at least in investments.
- After 1997 Asian Financial Crisis, China was expected to devalue the Yuan to remain competitive, but didn’t, much to the relief of the rest of Asia.
- Deflation after 1997 as money demand increased faster than supply.
- Inflation came back after 2004, and PBC included other currencies in peg in 2006. In real terms, RMB rose 25% against the Dollar, easing inflationary pressure but eroding value of Dollar assets.
If you owe the bank
Elliott Parker, 7/6/2009
Currency Issues

- RMB kept low after 2000 through massive purchases of U.S. Bonds by PBC. Rising forex reserves financed money growth, but accommodated by rising money demand.
- PBC began to build up large foreign exchange reserves – mostly invested in US Treasuries.
- This savings outflows counteracts the Balance of Payments surplus from trade and foreign investment, and keeps the currency from appreciating and making exports more expensive.
- The problem is that these purchases of foreign reserves increase the money supply, and can be inflationary.
- The problem for the Chinese is that they now own $2.5 trillion in foreign exchange reserves, much of it in US Dollars. What do they lose if the Dollar depreciates?
In real terms, Yuan has appreciated since 2006.
What if the Chinese stop lending?

“If you owe the bank $100 that's your problem. If you owe the bank $100 million, that's the bank's problem.”

- J. Paul Getty

If we owe foreign central banks $2 trillion, then what happens if they think we can’t pay them?

- This debt is denominated in Dollars, so depreciation hurts them, not us.
- You can’t, however, keep borrowing after that. Interest rates will rise, along with the U.S. risk premium.
- We will also lose the seignorage from the Dollar’s use.
The Effects of The Great Recession

- The Great Recession affected China, but did not cause a recession. Instead, it slowed export demand.
- To keep growth up and continue the transition of labor from agriculture to light industry, China’s government launched a fiscal stimulus of about $600 billion (10% of GDP, comparable to $1.4 trillion in USA).
China’s Housing Bubble

- For almost two decades, China has been trying to privatize its housing stock.
- China’s high investment (plus the fiscal stimulus) has gone largely into construction.
- Prices have soared due to speculation, but analysts expect they have a bubble in commercial and residential real estate.
- What happens if this bubble bursts too? Certainly it would affect China’s growing imports, commodity prices, Chinese banks, and China’s foreign savings outflows.