|  |  |
| --- | --- |
| **ECON 4033: Money and Finance in China**  **Answer Sheet for Assignment** | |
| **Student name in Chinese:** | **朱烨** |
| **Student name in English:** | **Hesse** |
| **Student ID:** | **1830001131** |



Financial repression means that governments employ regulations, laws and other non-market restrictions to prevent the financial intermediaries from operating normally in accordance with market laws, so as to concentrate more funds for state sector.

We can see that the Northeast and Inner Mongolia regions have relatively high loan-to-deposit ratios, and they have not reduced in 1990s. Since in 1990s , China is in the node of shifting from a planned economy to a market economy, there are few commodities on the market for the people to consume, and the people’s income is low and their consumption power is insufficient, the heavy debt mainly comes from investment and government expenditures in these three provinces.

And the SOE percentage shares in 1993 shows that in the Northeast and Inter Mongolia, most economic output and employment come from state-owned enterprises. That is because they were the first regions in China to begin industrialization, they established an economic system dominated by the state-owned economy, and received the Soviet Union’s financial and technical assistance for the construction of state-owned heavy industrial enterprises.

So the logic is that the Chinese government has established state-controlled financial market by protecting the monopoly of four state-owned commercial bank in 1980s and heavy-industry-oriented development strategy (James 2007) and the government repress the financial system by making easy loan from SOBs(state-owned bank) to SOEs and policy directive to maximize the flow of financial resource to government that needs to implement its induetrialization strategy.

The bottom three are in the Southeast China, the frontline of reform and opening up. We can see that they has keeped a relatively balanced budget and after the Southern Tour in 1992, there was a lighter debt burden, and the proportion of state-owned economy is relatively small.

This is because the southeast region is not the traditional heavy industrial area. It does not focus on the development of resource-intensive industries that require a large amount of capital investment, but forms an economic system dominated by labor-intensive light industrial industries and service industries, therefore, SOE has a smaller percentage in output and employment compared to the Northeast China. After the reform and opening up, the growth of the Southeast China main depends on labor migration from the middle China and FDI, instead of a large amount of capital investment led by the government, so there is less debt; The government and SOEs have less control over the market, the financial market is more sound, the economy is more developed, and more savings are generated, therefore there is a lower, further reduced loan-to-deposit ratio with development and opening.

Reference

James Riedel, Jing Jin, and Jian Gao (2007), How China Growth: Investment, Finance, and Reform. Princeton University Press.



a) The dotted line is the United States, the solid line is China.(source: International Monetary Fund, World Economic Outlook Database, April 2021)

Use two y-axis is better to compare.

b) US is officially in recession in 2001,2008 and 2009. We can see that the share of investment in GDP goes down during recessions in US.

According to the neoclassical model of investment behavior, investment will increase if frims have higher anticipated profit and lower opportunity cost. In the calculation of NPV, a recession leads to lower anticipated profit at each period for each firm and higher opportunity cost, the NPV of each frim becomes smaller, even negative. Therefore, people have less willingness to invest, and more investments are given up.

c) The investment share of GDP of China rised during economic downturns in 2002-2003 and 2008-2009. There are many reasons why China's investment behavior is completely different than that of the U.S.

First, who invest? In China, the sources of investment are mainly SOEs and government. They are controlled by administrative orders and are less affected by the market;

Second, why invest? In US, frims and investors are looking for return in the future, and invest in the information-developed financial industry. But in China, government-led investment mainly invests in fixed assets for infrastructure construction. This kind of investment is long-term and stable, and is not as sensitive to risks as the financial market. In addition, increasing investment is also a method used by the Chinese government to restore economic growth and increase employment. Therefore, when the economy slows down, China will not be affected by higher risks, higher costs, and less profit, but increase the investment.

Third, how to invest? In China, SOEs can get loan from SOBs no matter how terrible the economic environment is, but in US, the frims are less likely to be financed when there is a recession.

Therefore, the NPV approach is not applicable to China, even to US in Roosevelt's New Deal, because the basic assumption: “the market is perfectly competitive, and the information is complete” is wrong. China has a state-controalled financial system and powerful government.

Yes, during the recent pandemic, the movement of people is restricted, factories cannot be started, and residents' consumption is restricted, Chinese government restored economic growth by implementing strict anti-epidemic measures, increasing investment, and encouraging consumption. When China fully resumed production and the world was caught in the epidemic and stopped production, China accepted global production orders, expanded investment in production, and further stimulated the economy. We can see in the first quarter of 2020, China's GDP growth rate fell to -9.7% due to the epidemic, but it recovered to 11.6% in the second quarter.

2. Young people at working age can earn money and save for their retirement, at the same time the old will cousume without working and saving when they are retired. Retirees receive pension from working people’s saving, when they is a higher proportion of retirees or says higher dependency ratios, more people cousume and less people save, the saving rate will decrease. It actually appeared in empirical data.
3. If we only start from the household consumption smoothing, we will ignore cultural factors and policy influences. Saving comes not only from household, but also firms and government. It alone can only explain part of it.(not limitation of the theory itself, but limitation of using it alone!)
4. For dividend policy, it leads to a low payout ratio. Frims can get high saving from the slow growth of wage cost, but pay a small amount of profit to shakeholders, because they more depend on self-fundraising;

For national savings, China also has a huge national saving due to rapid growth rate and tax reform. Instead of pay the “excess” to shareholders, government mainly put it into construction and investment.

For consumption, since shareholders(the citizens, stockholders) get small dividend, it limits the consumption.