

# The Economics of China

## Introduction



Fall 2020

# The Chinese Economy in Context



# The Chinese Economy in Context

- In 1978:<sup>1</sup>
  - China's GDP was 293.6 billion USD.
  - India's GDP was 292.2 billion USD.
  - USA's GDP was 6.3 trillion USD.
- In 2018:<sup>2</sup>
  - China's GDP was 10.8 trillion USD.
  - India's GDP was 2.8 trillion USD.
  - USA's GDP was 17.8 trillion USD.

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<sup>1</sup> <https://databank.worldbank.org/source/world-development-indicators>

<sup>2</sup> Same source using data on GDP (constant 2010 US\$)

# The Chinese Economy in Context

- Depending on which measure of GDP is used, the Chinese economy is the largest or second largest economy in the world as of 2019.
- As mentioned in the textbook:
  - For the past 35 years, China has been the best-performing economy in the world.
  - China's gross domestic product (GDP) has grown faster for longer than that of any other economy in history.
  - China has forged its own development strategy in a way that no country has ever done before, independent of the simplistic prescriptions of some brands of orthodox economics.

# The Chinese Economy in Context

- Two fundamental processes of economic development:
  - "**Structural change** refers to real changes in the distribution of resources and activity."
  - "**Institutional transformation** refers to changes in the organizations, information, and incentives that guide economic decision-makers."
- These processes may lead to economic growth (development) if they result in improving productivity.
- Over the past 3-4 decades, the Chinese economy has:
  - transformed from mostly agricultural "into a primarily urban industry and service-oriented economy."
  - transformed from a non-market "to a pre-dominantly market economy."
- With these transformations, the Chinese economy witnessed so-called "miracle growth" during these decades.

# The Chinese Economy in Context

- Four favorable factors have played a role in the success of China's economic development, according to the textbook:
  - **1. Extraordinary human resources:** "already relatively healthy and literate at the end of the 1970s..."
  - **2. Global division of labor:** that started in the beginning of the 1980s
  - **3. Enormous "catch-up" potential:** at the end of the 1970s.
  - **4. A government with the capacity to learn.**

# The Chinese Economy in Context

- As mentioned, in terms of GDP, China has become the largest or second largest economy in the world.
- What about GDP per capita (or income per person)?
- China managed to grow from a low income into an "upper-middle-income" economy.
- "China's population is already much better off and has escaped the most severe forms of poverty."
- After this success, it is natural to aim to become a high income economy.
- "Reaching high-income status requires stronger technical capabilities, better institutions, and more innovation."

# The Chinese Economy in Context

- What about other growth miracles? Which path will China follow?
- Mostly East Asian, **growth miracles** refer to economies that enjoyed "**sustained rapid growth**".
- Some of these economies (such as Japan and South Korea) became high income, but their growth miracles ended "abruptly".
- Others (such as Thailand and Indonesia) got "stuck" at middle income.
- These growth miracle economies (including China) share four common features according to the textbook.



# The Chinese Economy in Context

- Common features of East Asian growth miracle economies:
  - 1. Rapid labor-force growth.
  - 2. Rapid structural change.
  - 3. High investment rates.
  - 4. An open economic policy that allows rapid growth of export-oriented manufacturing.
- Growth miracles cannot go on forever:
  - Catch-up growth and high-return investment opportunities eventually get exhausted. Also, labor-force growth starts to slow down.
  - Structural change from workers moving out of low-productivity agriculture is exhausted when all young workers have left the farm.
  - As the costs of labor-intensive manufactures rise, exporters lose competitiveness.

# The Chinese Economy in Context

- Over the past decade and a half, the Chinese economy started to show signs of the end of its growth miracle stage:
  - "Overall growth from 2005 to 2015 was rapid, averaging 9.5% annually, but after 2010 growth rates began a steady, gradual decline to 6.7% in 2016."
  - Labor force growth went into reverse after 2011.
  - Rural-to-urban migration started to drop in the 2010–2015 period and continues to fall.
  - The share of manufacturing and investment in GDP started to decline.
  - From being one of the world's largest host countries for inward foreign direct investment (FDI),...China now resembles a developed country with balanced inward and outward FDI flows.
  - Income inequality seems to have peaked and started to decline (Kuznets Curve).

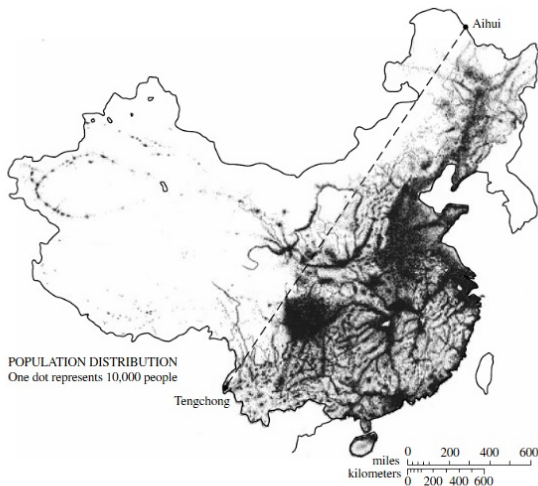
# The Chinese Economy in Context

- Now, new approaches and policies are necessary to sidestep crisis and disruption and to sustain moderately rapid growth.
- Chinese policy-makers seem to be aware of this, and have already started with some policies aiming to tackle this challenge.
  - Moving from The One-Child Policy to a two-child policy in 2016.
  - Moving from taxing farmers to subsidizing agriculture.
  - Rebuilding a social safety net, including health insurance and universal education.
  - **Rolling out a series of activist industrial policies designed to foster the emergence of so-called “strategic emerging industries,” industrial automation, and internet-based services.**
  - **At the same time, government investments in infrastructure and research and development have been increased.**
- The last two points mark a difference between the Chinese approach and that of Japan and South Korea when it comes to the government's role in the post growth miracle stage.

# The Chinese Economy in Context

- It also marks a difference between the approach during the transitional phase that started in 1978 where China moved from a government managed economy to a market-oriented economy.
- Today, a Chinese economic system has emerged that indeed relies predominantly on the market, especially in the downstream and foreign-trade sectors, but also retains a robust, relatively centralized state sector in some industrial and service sectors, including finance.

# The Geographical Setting



**Figure 2.1**  
Population distribution and the Aihui-Tengchong line.  
Source: Based on Sun (1988).

# The Geographical Setting

- China is big, rugged, and diverse.
- This imposes an additional challenge when it comes to economic development.
- As a result, modernization in China has meant overcoming geographic isolation and high transport costs, and the creation of an integrated national market and economic space has been a key part of development.

# The Geographical Setting

- China has only a single seacoast.
- So one way to think about different regions in China is whether a region is coastal or inland.
- Proximity or distance from the coast has its implications on economic activity.

# The Geographical Setting

- East-southeast of the Aihui–Tengchong line, the country is lower in elevation and has ample water.
- As a result, 94% of the population lives in the eastern half of the country.
- This in turn affects economic activity in different regions.
- So another way to think about different regions in China is whether a region is east-southeast or west-northwest of the Aihui–Tengchong line.



# The Geographical Setting

- Less than 15% of China is arable.
- China has less arable land per capita than India.
- The United States, with one-fourth of China's population, has more arable land than China and could easily bring much more land into cultivation.
- China has adapted to the scarcity of arable land by developing labor-intensive agricultural techniques that enable it to wrest more total food grain from the soil than any other country.
- When account is taken of the highly uneven distribution of resources and population—especially the scarcity of water in the north and west—it is clear that enormous problems of environmental degradation challenge China.

# The Geographical Setting

- Shanghai is economically the most important city in China.
- Today, the Beijing–Shanghai connection— now a high-speed rail link— once again defines the central axis of the economy.
- The rapid growth of an externally oriented economy since 1978 has transformed Southeast China.
- Four special economic zones (SEZs) were set up in 1979–1980 to attract investors to China:
  - Shenzhen close to Hong Kong.
  - Zhuhai close to Macau.
  - Xiamen close to Taiwan.
  - Shantou SEZ was established in the Chaozhou (Teochiu) ethnic homeland to attract investment from this group, which is especially important economically in Southeast Asia.

# The Geographical Setting

- China is becoming much “smaller” ...thanks to the extraordinarily large (infrastructure) investments that have accompanied rapid economic growth.
- Three main areas of infrastructure investment: ports, domestic land transport, and telecommunication.
- Ports:
  - Today, China is by many measures the most connected country in the world.
  - It has 6 of the world's 10 busiest ports (Shanghai is the largest).
- Domestic Land Transport:
  - China has now built a national expressway network that is the world's largest, at 123,500 kilometers.
  - A new wave of transformation is occurring with the advent of high-speed rail.
- “Belt and Road Initiative” covering both land and maritime transport.

# The Geographical Setting

- “Belt and Road Initiative” has been given steadily increasing visibility through 2017.
- Containing many different initiatives, it will have important economic effects.
- For example, a high-speed rail corridor will likely extend from Yunnan down through Southeast Asia to Singapore; and connections with Russia and inner Asia will multiply.
- Telecommunication:
  - 1.27 billion mobile phone subscribers (more than one for every adult), and 577 million broadband Internet connections were in use at the end of 2015.

# The Geographical Setting

- For almost 30 years after the beginning of China's market transition, economic growth was more rapid in the coastal provinces than in inland provinces.
- Both economic forces and government policies played a role in this.
- Rapid growth led to increases in wages, value of land, congestion, and pollution.

# The Geographical Setting

- As a result, competitiveness of China's existing exports eroded due to increased costs of production.
- In addition, businesses began to move production inland in search of cheaper land and lower wages.
- Hence, a few years into the twenty-first century, the tilt toward the coastal regions stopped and gradually went into reverse.
- Government policy also encouraged this change.
- In 1999, the Chinese government officially launched the Western Development Program to give preference to western and inland provinces in investment projects and other economic development policies.

# The Geographical Setting

- As labor costs rise in the coastal regions, some economic activity will move (keep moving) inland.
- China's vastly improved infrastructure will facilitate the redistribution of activity and new patterns of urban development.
- China's land connections to its neighbors is expected to (continue) expand.
- As a result, this will create communications and transport corridors in regions long thought of as frontiers and barriers.

# Suggested Videos

- <https://www.youtube.com/watch?v=0JDoll8OEFE>  
(I have nothing to do with the ad in the video!)
- <https://www.youtube.com/watch?v=CexUGGejPw0>