

*The End of Hyper-growth:  
Political and Economic Responses  
to a Slowing China*

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# Conclusions (Seriously)

Forces that are slowing Chinese growth can be grouped into three baskets: long-term structural; medium-term systemic; and short-term macroeconomic (Keynesian). Because of this:

1. Interactions make the economy more unpredictable, and raise possibility of “correction.”
2. Short-run Keynesian stimulus is not an option because it would make it harder to solve medium and long-term issues.
3. There is wide recognition of this in Beijing, but no consensus on next steps.
4. This make it more likely that a substantial renewal of market-oriented reform can occur next year, although this is still far from certain.

# Introduction: The Chinese economy has been growing more slowly.

Until the beginning of 2012, the biggest challenge to the Chinese central bank had been to bring inflationary pressures—an incipient inflationary episode—under control. They were having reasonable success.

Starting in April 2012, substantial evidence emerged that the Chinese economy was slowing more abruptly than expected. Amid general nervousness, the central bank shifted to a more accommodative stance, and cut interest rates twice (June 8 and July 6).

- The downward momentum has increased because global (European) weakness and Chinese weakness are coinciding.
- Inflation dropped sharply, with falling prices in some months.
- Market interest rates peaked in Q3 2011, with credit demand weakening since.

How steep will the slowdown be? How long-lasting? Could the world's fastest-growing economy slip into recession?

Can China make the transition to stable, balanced—and slower—growth, under radically new conditions?

# Changing Fundamentals

A completely new set of economic and political conditions are emerging in China. These are “long run” changes, but occurring quickly, right now.

For the past decade, China has been in a “super-phase” of accelerated growth. China has grown faster, longer, than any economy in history. GDP growth pushed above 10% for five years in a row. This super phase was driven by:

- Successful reforms in the 1990s;
- Massive investment that facilitated rapid structural change;
- WTO membership, and (until 2008) robust global growth.

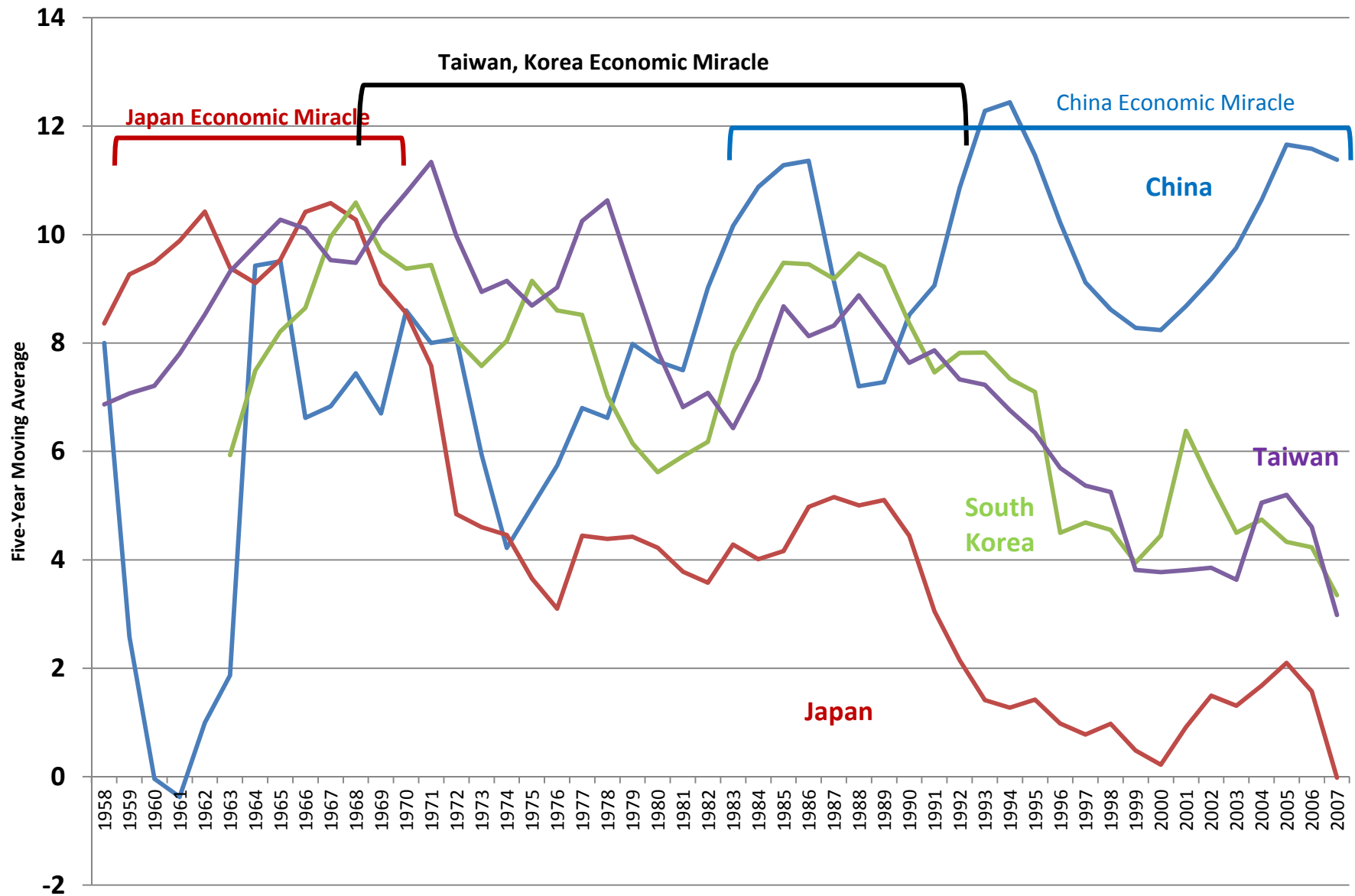
A side effect of these favorable economic conditions was that the impetus for reform evaporated. Even when challenged in the global financial crisis, centralized control over investment and credit seemed entirely adequate, so long as it was decisive. Reformers lost traction, and China’s institutions failed to keep up with rapid economic development.

This era is now over, and China is launched into a new and challenging economic environment. Examine through the lens of three forces operating on different time scales.

# I. The Long-run: Structural Change and the End of Hyper-Growth

- China's unique features are completely compatible with a classic East Asian "hyper-growth" story.
- Virtuous circle of external markets; structural change; high investment in both physical and human capital; rapid upgrading.
- These phases come to an end, and while we understand the underlying causes well enough, we do not understand the specific triggers and processes of slowdown.

# Gross Domestic Product (GDP)--Growth Rates



# Underlying Structural Shift in China is Occurring Very Quickly

Hyper-growth phases eventually end. The end is associated with changes in labor supply conditions, the end of a “labor surplus” country.

This shift is especially dramatic in China because three long-run changes in labor market conditions are occurring simultaneously, and right now:

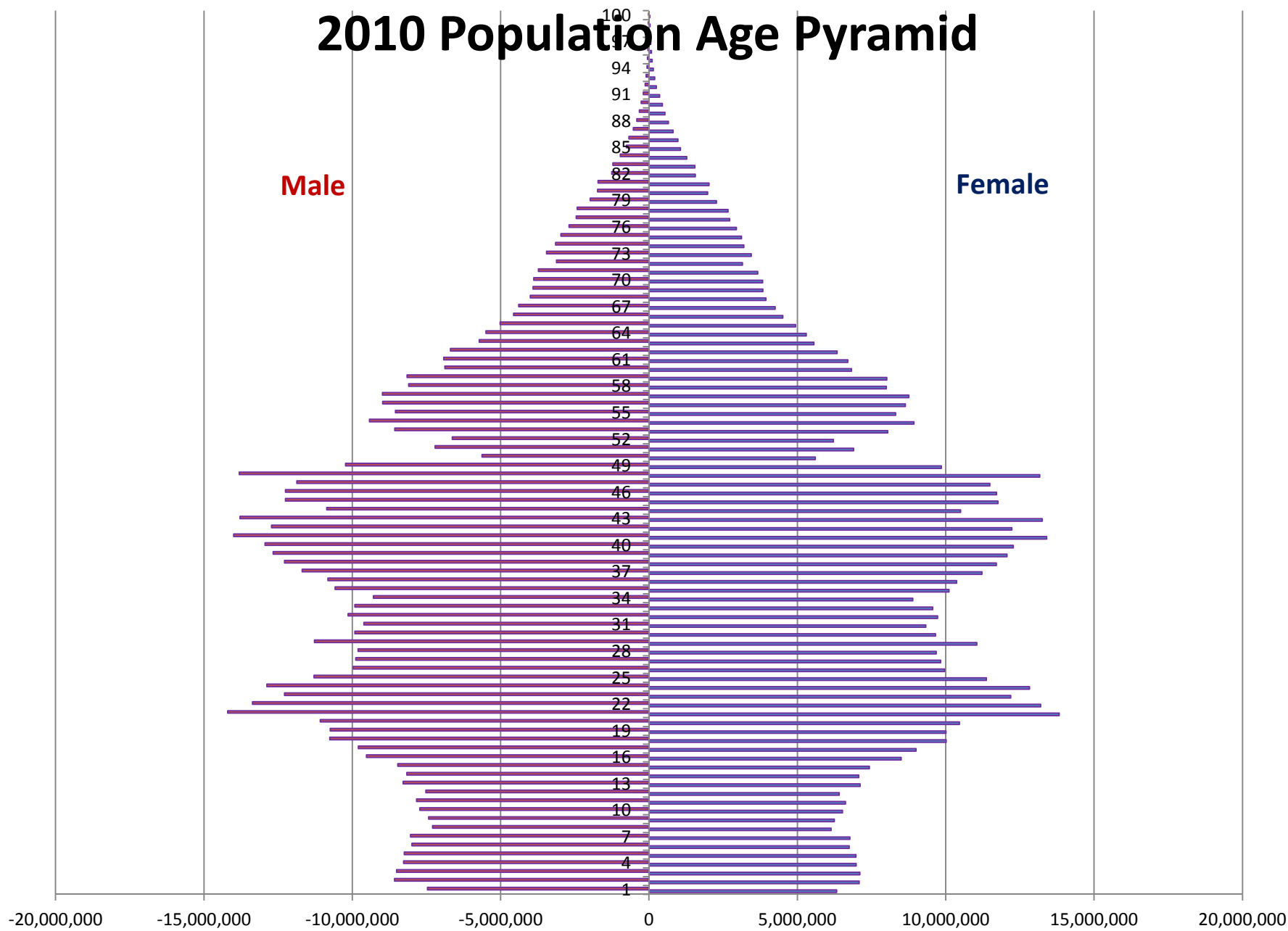
- Demographic (aging);
- Structural (rural-urban migration);
- Educational factors (much higher rates of college education).

These changes have already begun & will only accelerate.

# 2010 Population Age Pyramid

Male

Female





# 2010 Population Age Pyramid

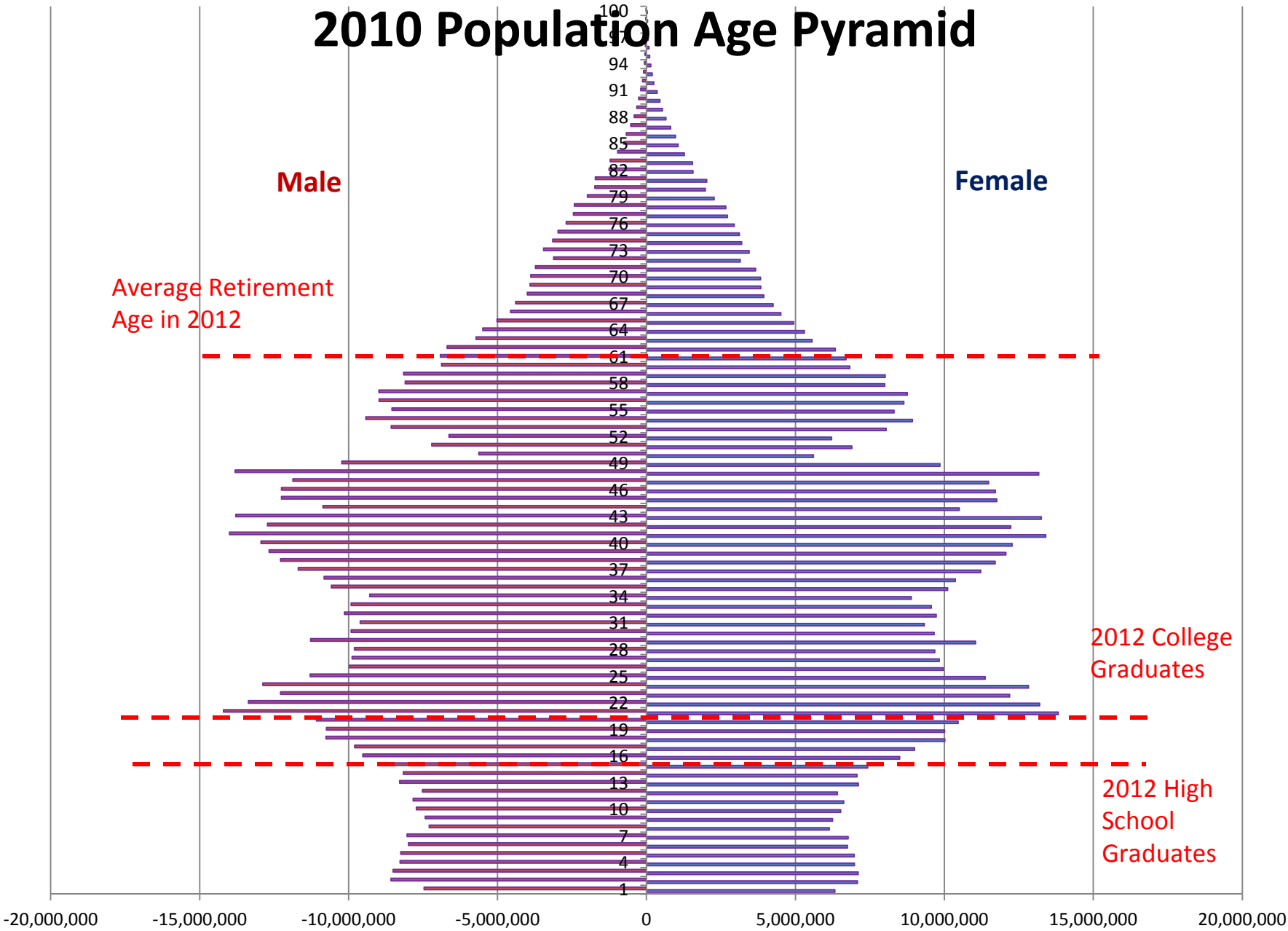
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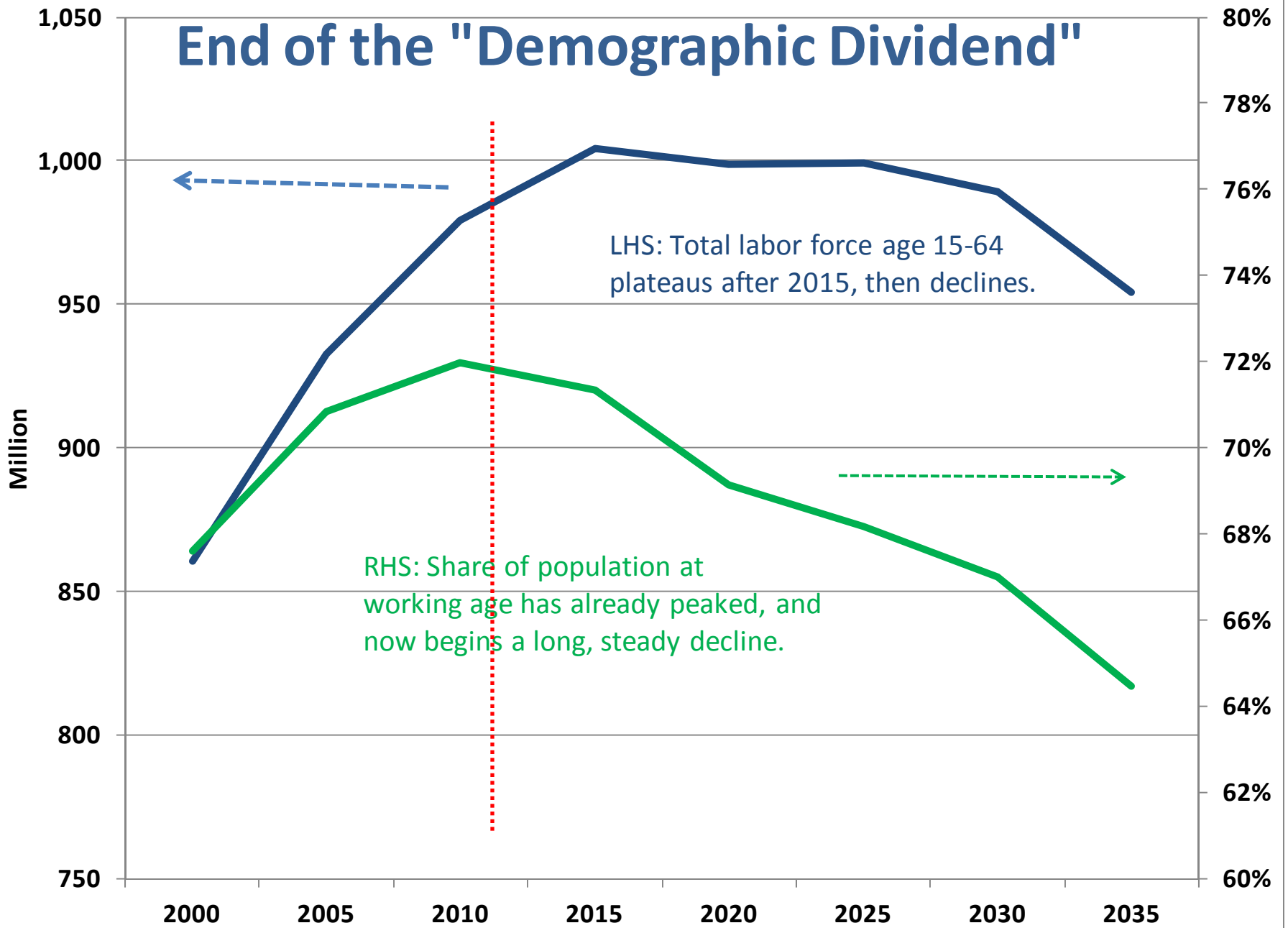
Average Retirement Age in 2012

2012 College Graduates

2012 High School Graduates



# End of the "Demographic Dividend"



LHS: Total labor force age 15-64 plateaus after 2015, then declines.

RHS: Share of population at working age has already peaked, and now begins a long, steady decline.

# Growth in Education Supply: Reinforce changes due to demography and rural-urban migration

	<u>2000-2010</u>	<u>2010-2020</u>	<u>2020-2030</u>
Total Labor Force Growth	115	20	-15
ow: With College Degrees	33	58	57
<u>Non-College Worker Growth</u>	<u>82</u>	<u>-38</u>	<u>-72</u>

(Net Change in Labor Force, in Millions)

## II. Medium-term: Stagnation of Institutional Reforms

- 1990s Reforms brought a long-lasting productivity dividend. (WTO membership and global trade expansion was both a part of this and a fortuitous complement.)
- Tremendous economic success, combined with “reform fatigue” produced complacency. The productivity dividend has been spent down, and not replaced by new institutional sources of productivity dividend.
- Multifarious micro-protectionism spreads in many sectors.
- Expect “systemic drag” on productivity from this accumulation of institutional barriers.

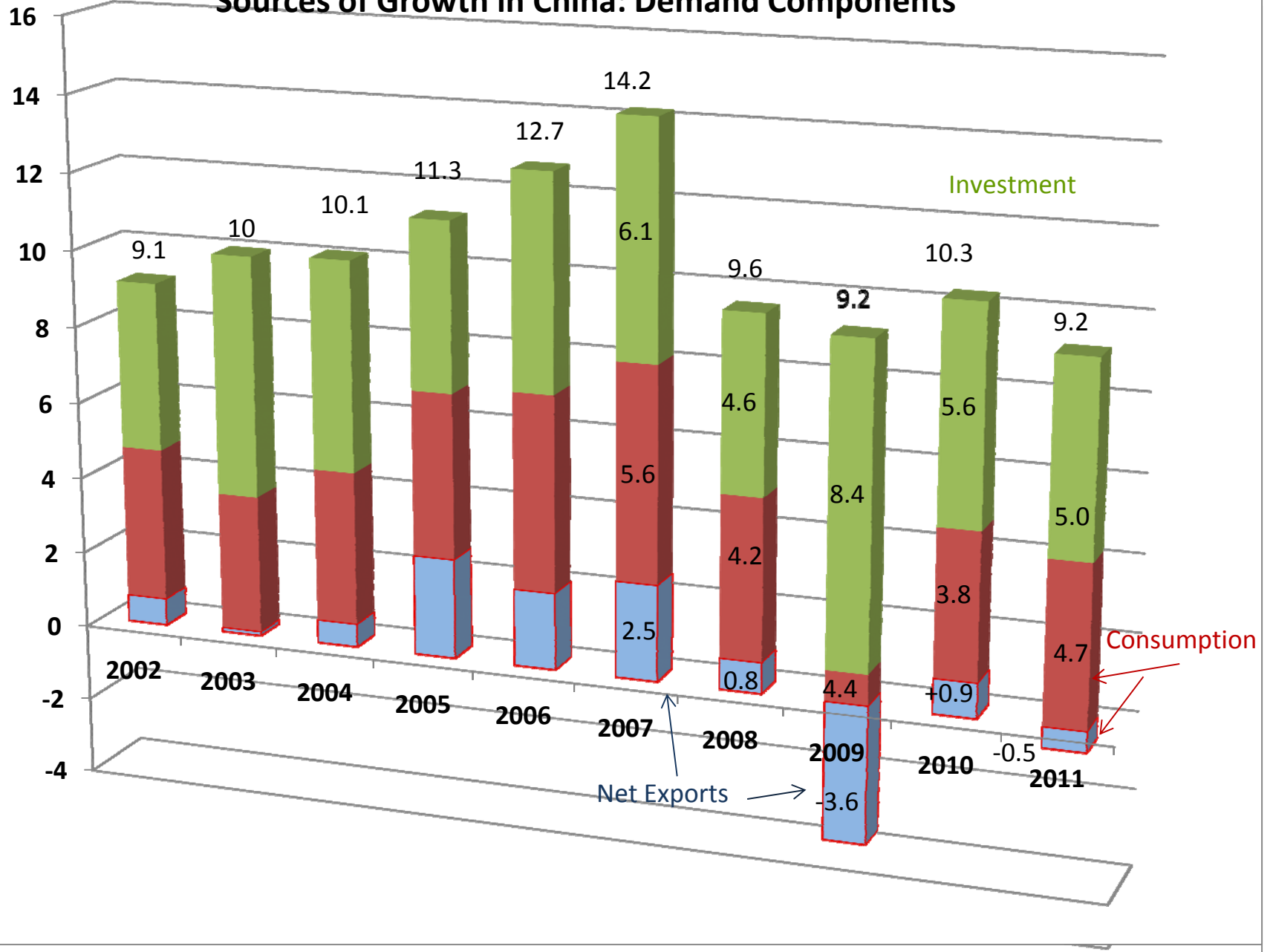
# Government Intervention Strongly Furtherers this Process

- State-owned enterprises receive ideological re-affirmation (2005-2006)
- Wen Jiabao administration steadily increases government intervention for programmatic purposes.
  - Science and Technology (2006-2020).
  - Stimulus Against Global Financial Crisis (2008-2009).
  - Strategic Emerging Industries (2009-present)
  - Housing Policies (recent wave, 2010-present)

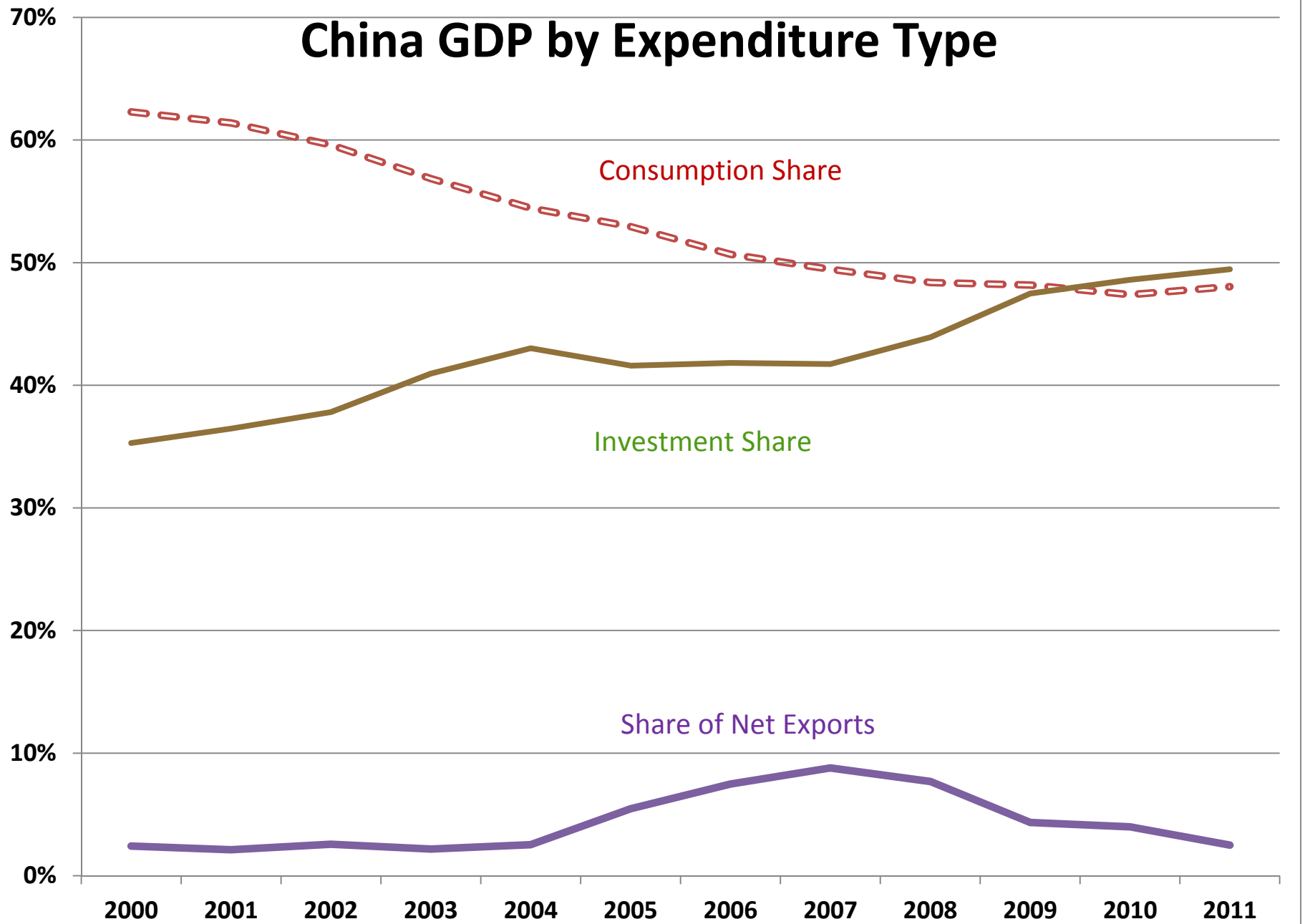
# III. Macroeconomic Cycle

- On the “down side” of three massive investment bubbles: infrastructure, housing, and strategic emerging industries.
- Easing export demand, driven by slowing mature economies and especially European crisis.
- China’s recent experience has been Keynesian demand maintenance driven by government investment control, with remarkable success.
- However, this approach can only be partially successful today.

### Sources of Growth in China: Demand Components



# China GDP by Expenditure Type





## IV. Conclusions

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