
Can We Expect Any Breakthrough in China's Economic Reforms?

Wenkui ZHANG

Development Research Center of the State Council, China

wkzhang@drc.gov.cn

Can We Expect Any Breakthrough in China's Economic Reforms?

1. The Need For Further Economic Reforms

In the past 30 plus years, China has achieved a 9.9% average annual economic growth, with a longest fast growth period in the world.

Its GDP per capita leaps from 1,000 USD in 2001 to 5,400 USD in 2011, thus becoming a upper middle income economy, although it is much lower than the US, Japan, and Korea.

Before the global financial crisis, China's growth peaks at a 14.2% rate in 2007 in company with high inflation, then drops.

Can We Expect Any Breakthrough in China's Economic Reforms?

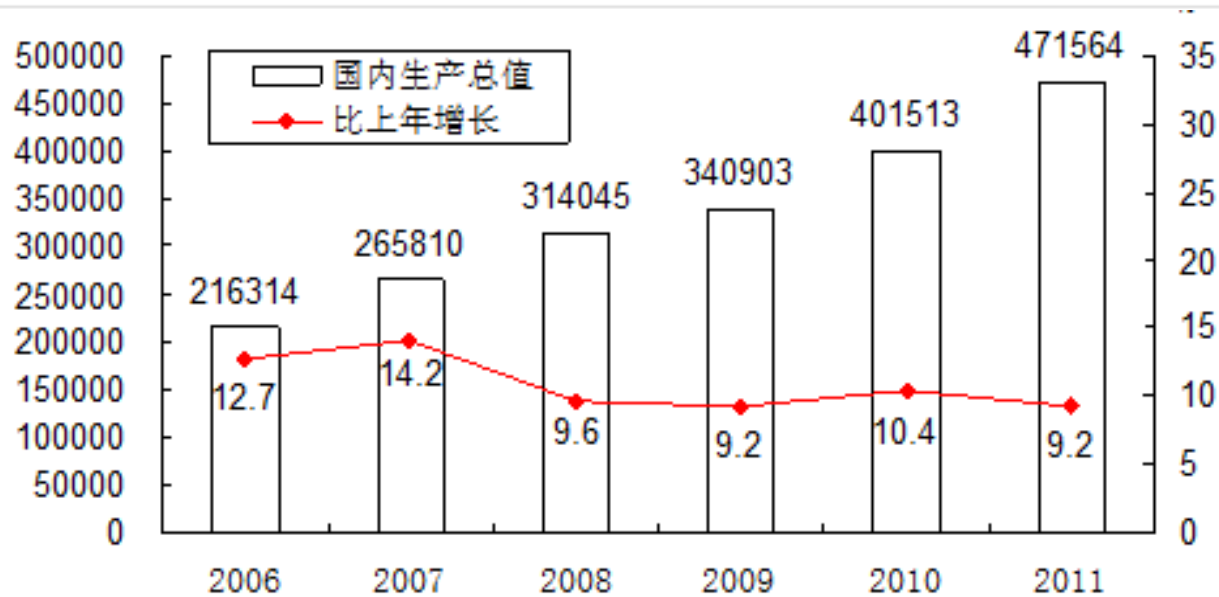


Figure 1: 2006-2011 economic growth (% , 100 million) Source: NSB

Can We Expect Any Breakthrough in China's Economic Reforms?

China's growth has been addictive to investment and export (investment in particular).

During the period of 2001-2011, the capital formation share in GDP soars drastically from 36.5% to 49.2%, while the household consumption share in GDP decline from 45.3% to 34.9%. Looking at Japan's experience, its historical peak of investment share in GDP is 36.4% in 1973, and the household consumption share in GDP hits 52.3% as the historical lowest in 1970. China also faces some other severe imbalances (high Gini coefficient, urban-rural gap, environment, etc).

With no doubt, China needs to do its rebalancing homework.

Can We Expect Any Breakthrough in China's Economic Reforms?

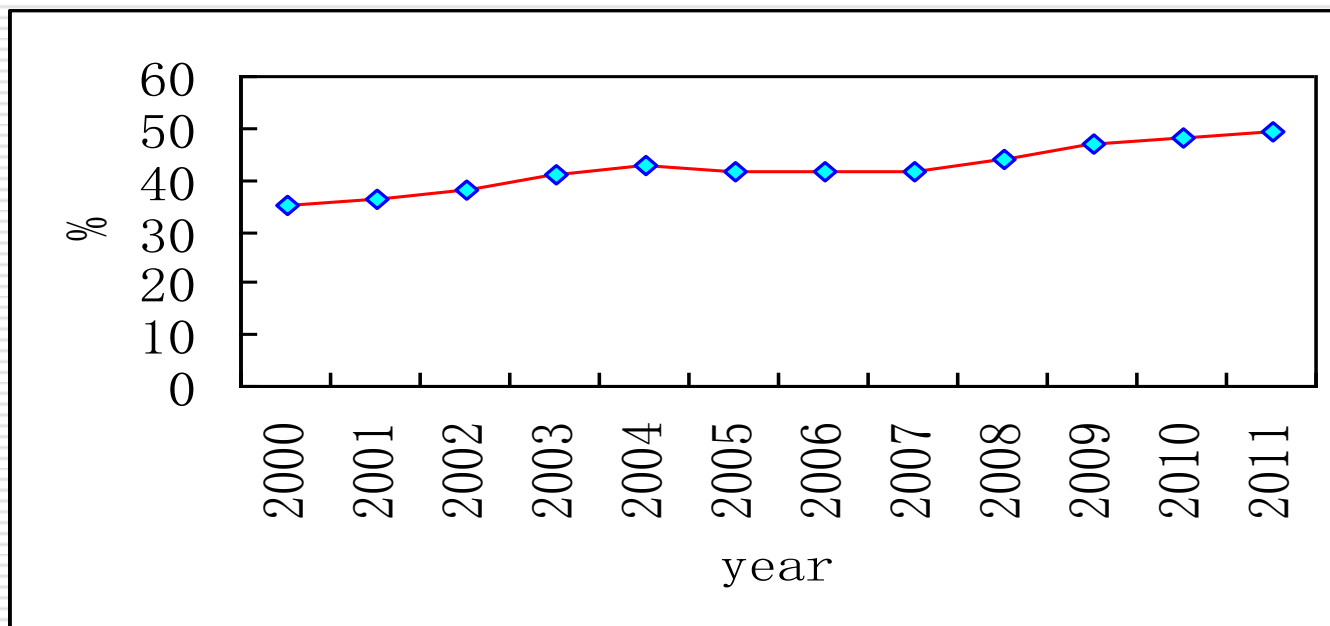


Figure 2: China's capital formation share in GDP Source: NSB

Can We Expect Any Breakthrough in China's Economic Reforms?

Those imbalances stem from its extensive catch-up growth phase (other catch-up economies faced similar imbalances), but China has its own problems, such as the state-owned enterprises and governmental involvements in factors distributions as well as widespread rent-seeking activities.

As the growth potential goes to a lower level, the new normal probably is 8% or so, the declining economic growth will bring pressure to rebalancing work. Looking forward, China needs further structural reforms, including enterprise sector reform, government sector reform, financial sector reform, social sector reform, labor sector reform, etc.

Can We Expect Any Breakthrough in China's Economic Reforms?

Table 1
China: Projected growth assuming steady reforms and no major shock
(average, in percent, unless otherwise indicated)

	2006~2010	2011~2015	2016~20	2021~25	2026~30
GDP growth (%)	11.2	8.6	7.0	5.9	5.0
Labor growth	0.4	0.3	-0.2	-0.2	-0.4
Labor Productivity growth	10.8	8.3	7.1	6.2	5.5
Economic Structure (End of Period, %)					
GDP by demand					
Investment/GDP	49	42	38	36	34
Consumption/GDP	47	56	60	63	66
Share of industry					
Secondary industry	46.8	43.8	41.0	38.0	34.6
Service	43.1	47.6	51.6	56.1	61.1
Share of employment					
Agriculture	36.7	30.0	23.7	18.2	12.5
Service	34.6	42.0	47.6	52.9	59.0
TFP					
Gross domestic saving	53	44	40	37	34
Current account	4	2	1	0	0

Source: DRC-CGE

Can We Expect Any Breakthrough in China's Economic Reforms?

2. The most difficult-to-reform sectors: SOEs sector and government sector

Currently the output share of the SOEs sector in GDP is roughly estimated to be 30%, but lots of the economic commanding heights are dominated by SOEs. Compared to non-state sector, the ROE in the SOEs sector is much lower. The SOEs sector is prone to over-investment.

The government has expanded its size and has heavily involved in economic resources distribution. The actual size of China's government is very large, considering there probably is another 10 PP government revenue excluded in table 2.

Can We Expect Any Breakthrough in China's Economic Reforms?

**Table 2: Size and composition of public expenditures,
cross country comparison, as percent of GDP**

Percent of GDP /*	High Income	Middle Income		China
	OECD	Upper Middle	Lower Middle	
Total Outlays	41.6	33.1	36.1	25.7
General public services	5.6	5.6	5.5	2.9
Defense	1.6	1.5	2.2	1.3
Public order and safety	1.6	2.0	2.6	1.3
Economic affairs	4.2	5.3	6.1	7.9
Environment protection	0.7	0.5	0.3	0.5
Housing and community amenities	0.8	1.2	3.0	1.9
Health	6.3	3.3	3.1	1.0
Recreation, culture and religion	1.2	0.8	1.0	0.5
Education	5.4	3.9	5.4	3.7
Social protection /**	15.2	9.0	6.9	4.7
Memo: total outlays excluding health and social protection	20.1	20.8	26.2	20.0

Sources: GFS, WDI and World bank staff estimations.

/* Data about all the countries are in 2007 except data about China is in 2008.

** China's Social protection includes both outlays to pension fund and to health insurance. Adding those financed from general budget, the total public expenditure on health totals around 2.5% of GDP in 2008.

Can We Expect Any Breakthrough in China's Economic Reforms?

The key issue for the SOEs sector reform is ownership transformation. There are some arguments and disputes. My personal vision for China's SOEs reform is to restructure the state ownership by selling out small and medium-sized SOEs and ownership-diversifying large SOEs, therefore the SOEs sector would be scaled down.

The key issue for the government sector reform is to recalibrate government's role and curb governmental discretionary powers. It is something related to the political system, we should be careful about this issue, but both the academics and the public are appealing for government sector reform.

Can We Expect Any Breakthrough in China's Economic Reforms?

3. Obstacles of the Further Reforms and the New Hopes

A. Mindset

As a socialist country, a large SOEs sector and strong role of governmental distribution of economic resources have been traditionally regarded as orthodox ideology. In the past three decades, China's reforms proceeded in company with redefining socialism.

B. Interest Groups

It is understandable that interest groups fight for their benefits. How to handle their appeals is a political issue.

Examples: Japanese Post, China Railway, China's SOEs, China's government officials.

Can We Expect Any Breakthrough in China's Economic Reforms?

C. Bargaining in Policy-making Process

Example: urbanization, Hukou system and social security system reform, and the inter-governmental fiscal relations.

To remove these obstacles is not easy. But China now is having some new hopes.

- new leaders. Usually new leaders are expected to do something new.
- exploring new sources for the future growth. Urbanization is becoming a focus. DRC and the World Bank are doing a new joint research. Correcting the imbalances and distortions are also necessary.
- the pressures from the public and from the academics. For example, the railway sector, the state-owned monopoly companies.

Can We Expect Any Breakthrough in China's Economic Reforms?

One hopeful area is budgeting reform, which will lead to state governance reform. In the past decade, government revenue has experienced faster growth than the GDP growth, the public and the corporate sector are making very strong complaints about the taxation and government spending, even local governments also make complaints about the disparities in inter-governmental finance. The expansion of government debts needs to address fiscal disciplines. Therefore, the odds are that fiscal system will be fixed up, that needs the people's congress to play substantial role, and press the government to improve the transparency.

But please bear in mind that China is a unique country, everything remains to be seen, let us keep our eyes open.

Thank You!