NUS National University of Singapore

Source: *The Straits Times,* pA21
Date: 14 January 2015

From a "demographic dividend" driven by abundant labour, China now has to cope with slower growth. Apart from innovation and technological progress, the "reform dividend" from further market reforms will be most critical for China's future growth in the New Normal.

Challenges facing China's move to slower lane

BY INVITATION

By JOHN WONG
FOR THE STRAITS TIMES

CHINA'S economic growth has lost momentum. Final gross domestic product (GDP) figures for last year are slated for release on Jan 20 but growth is likely to be around 7.3 per cent, the lowest in 15 years and a marked decline from the 7.7 per cent of 2013. With the economy still facing a lot of headwinds, growth for this year may slow further to 7.1 per cent, or even 7 per cent.

President Xi Jinping, however, has openly embraced this moderate growth as the New Normal.

At the Asia-Pacific Economic Cooperation meeting in Beijing in November last year, he publicly dismissed any potential risk from such a slowdown as something that is really "not so scary". Indeed what is "low growth" for China is still very high growth by both regional and global standards.

In any case, it is true that China, an economic mammoth of US$10 trillion (S$13.3 trillion) in total GDP, should not be growing at its former breakneck rates.

A growth of merely 7 per cent for China will generate an increase in GDP in one year that equals more than two-thirds of Indonesia's total GDP and one-third of India's total GDP. The latest growth figures for Indonesia and India were only 5 per cent and 5.3 per cent respectively.

China's economic growth has decelerated since 2010. But it is only recently that the Chinese leadership has come out to endorse this lower growth threshold as the New Normal.

Why might this be so?

First, President Xi and his economic policy colleagues have obviously come to terms with the fact that all high growth has to come to an end.

China chalked up double-digit rates of hyper-growth for over three decades (averaging 9.8 per cent a year for 1979-2013 and 10.5 per cent for 2001-2012). That is a much longer stretch than that attained by the East Asian "tiger" economies of Japan, South Korea, Taiwan and Singapore.

More significantly, China's major sources of growth have, in recent years, been fast depleted or seriously weakened.

Structural factors slowing growth

FOR years, China's growth has been mainly investment driven. But excess capacities in its many heavy industries, coupled with the cooling housing market, have recently depressed domestic investment. Domestic consumption (very low, at about 40 per cent of GDP) has not risen fast enough to compensate for the decline in domestic investment. Meanwhile, external demand has plummeted due to the erosion of China's export competitiveness as wages rise and the yuan appreciates.

China's major growth drivers on the demand side have, in varying degrees, been weakened.

On the supply side, China's past growth was associated with the transfer of its surplus labour from low-productivity agriculture to higher-productivity manufacturing. But such growth potential is fast being exhausted.

The population in the age group of 15-64 peaked in 2010 at 74.5 per cent, with the labour supply reaching the so-called Lewis Turning Point, when there is no more cheap agricultural workforce to be tapped.

Though immediate labour shortages have not yet resulted, it does imply that China has spent its "demographic dividend" (its youthful workforce) and is losing comparative advantage for a wide range of labour-intensive manufacturing activities.

At the same time, the relatively easy productivity gains in the early periods of market reforms plus technological progress from imported new machines and equipment are now things of the past.

Together, these point to a period of slower growth.

Also a 'policy induced' slowdown

OTHER non-structural reasons explain China's slowdown. These can be traced to policy decisions.

Mr Xi's relentless campaign against corruption and rent-seeking activities, which helped him to consolidate power, has generated collateral damage to economic growth in the short run.

The anti-extravagance measures covering official travel, official dinners and other perks have reportedly reduced domestic consumption. Corruption investigations at various levels of government have created uncertainty in the bureaucracy, leading to inaction of government officials and even political paralysis, particularly at the local level.

In the financial sector, too, a clampdown on local government debt and shadow banking has created a macroeconomic environment that is squeezing economic growth.

More critical is the Chinese government's own changed perception on the nature of economic growth.

In 1979, Deng Xiaoping launched economic reforms to maximise economic growth for China – "to get rich is glorious". China's economic policymakers have since followed the single-minded pursuit of GDP growth, almost at all costs.

This sparked off double-digit rates of growth for over three decades, with China's per-capita GDP in 2013 about 100 times more than that in 1979.

However, such a blatant GDP pursuit as an end in itself comes with high social costs, ranging from high income inequality (Gini ratio at 0.48) to such undesirable by-products (negative externalities) as serious air and water pollution.

Mr Xi has clearly made a decisive departure from China's time-honoured GDP-dominated pro-growth policy. Thus, China's National Bureau of Statistics, which compiles the country's GDP accounts, was instructed to take steps to end "GDP supremacy" by radically revising its conventional GDP accounting to give higher weights to other "quality aspects" of growth.

This means China's future economic growth performance will not be driven by GDP increases alone. Instead, it will aim for comprehensive targets like stable growth, employment, inflation and so on.

The government is more likely to stick to its long-term goals of structural reforms and industrial upgrading, and not be distracted by short-term dips in GDP indicators. Unlike in the past, the government will be less likely to resort to unnecessary stimulus measures to artificially boost short-term GDP growth.

'Reform dividend' for future growth

IN EMBRACING the New Normal of slower growth, Mr Xi faces two critical challenges.

First, how to speed up economic restructuring and rebalance growth to be based more on domestic demand. This would make China's economic growth more sustainable in the longer run.

Second, how to cultivate new sources of growth. Mr Xi has envisioned the more "advanced mode" of growth in future, which depends on innovation and technological progress to generate the needed productivity growth. This, in turn, means a greater role for research and development (R&D).

Though China's nascent R&D infrastructure is weak compared with developed countries, its R&D spending has rapidly grown in recent years, reaching 2 per cent of GDP last year, compared with 2.8 per cent for the United States and 3.4 per cent for Japan. China's global share of R&D spending is actually the world's second largest after the US.

China leads the world in terms of new patents filed, but its weak intellectual property rights regime has not been conducive to the commercialisation of innovation.

Much of its past growth was essentially derived from the sheer injection of a massive amount of capital (from high domestic savings), along with abundant cheap labour. China has exhausted such a "demographic dividend" due to declining fertility.

Future growth will, therefore, have to shift from dumping in more inputs to fostering greater total factor productivity growth, not just through technological innovation but, even more critically, further market reform. In other words, the potential "reform dividend" will drive future growth under the New Normal.

At the Third Party Plenum in November 2013, President Xi announced a comprehensive reform package covering financial sector reform, central-local fiscal relations, competition policy, state-owned enterprises reform and so on.

At the Fourth Party Plenum in October last year, the main reform focus shifted to legal reform to strengthen China's "rule of law". An effective and functioning legal framework is indispensable for good governance, and for successful implementation of various reforms.

In the final analysis, Mr Xi's reform endeavour will be most critical for the next phase of growth under the New Normal. The challenges to him are no less formidable than what Deng had faced in initiating the first round of market reforms over three decades ago.

stopinion@sph.com.sg
The writer is a professorial fellow at the East Asian Institute, National University of Singapore.

Source: The Straits Times © Singapore Press Holdings Ltd. Permission required for reproduction.