Chinese Economic Outlook: The Next Five Years

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A Preview

- The Chinese Economy Today
- The Economic Development Agenda—Building a Moderately Well-Off (Xiaokang) Society by 2020
- Impact of the Entry of China into the World Economic System
- Prospects for Future Economic Growth

The Chinese Economy Today (1)

- East Asia is the fastest-growing region in the world over the past two decades, the East Asian currency crisis of 1997-98 notwithstanding.
- China is the fastest growing country in East Asia—approximately 9% p.a. since beginning of economic reform (1979) and 7.7% over the past five years.
- Between 1979 and 2002, Chinese real GDP grew from $177 billion to $1.25 trillion (2002 prices) (6th largest GDP in the world) and real GDP per capita grew from $183 to slightly less than $1,000. The U.S. GDP (approximately $10.5 trillion) and GDP per capita (approximately $37,000) are respectively more than 8 and 37 times the comparable Chinese figures in 2002.
- China survived the East Asian currency crisis relatively unscathed.
- China is one of the very few socialist countries that have made a successful transition from a centrally planned to a market economy—the 10th Five-Year (2001-2005) Plan is only indicative and not mandatory; the rate of interest (the price of money) and the exchange rate are the only prices that are still administratively determined on the margin.

The Chinese Economy Today (2)

	1979	2002
	US$	(2002 prices)
Real GDP	177 bill.	1.25 trill.
Real GDP per capita	183	980

The Chinese Economy Today (3)

	U.S.	China
	US$ (current prices)	
2002 GDP	10.5 trill.	1.25 trill.
2002 GDP per capita	37,000	980

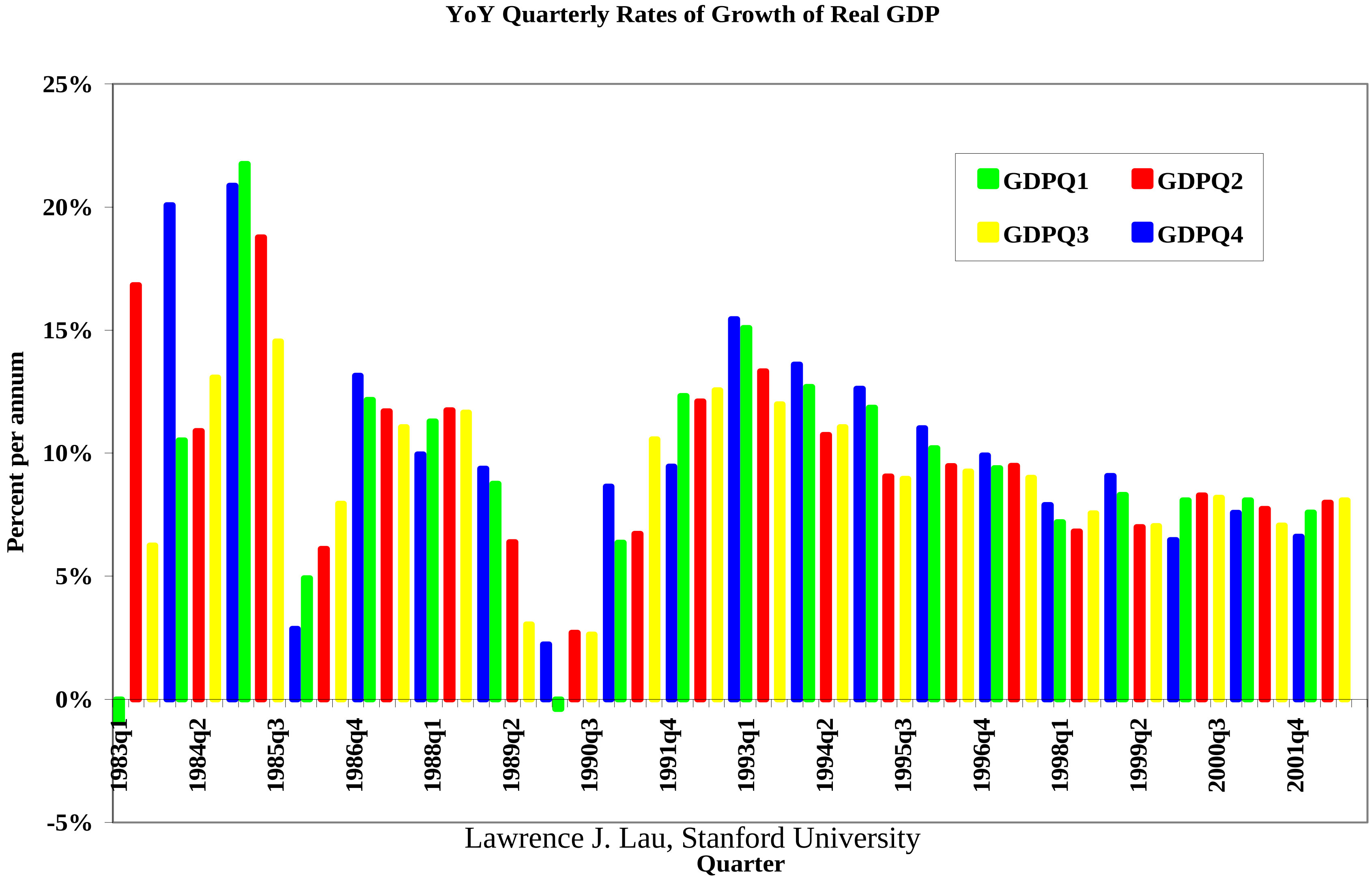
The Chinese Economy Today (4)

- The private (non-state) sector accounts for more than 65% of GDP and an even greater percentage of employment in 2002—non-state-owned firms face hard budget constraints and ordinary citizens can make a good living without being beholden to the state.
- China is no longer a “shortage” economy--insufficient aggregate demand is a real possibility.
- China is the 6th largest trading country in the world (exports of goods of US$325.6 billion—an increase of 22.3% over 2001—and imports of goods of US$295.2 billion—in increase of 21.1%—totaling US$620.8 billion in 2002).
- China has been rapidly becoming a major destination for the exports of other East Asian economies.
- Chinese accession to the World Trade Organization has been very smooth; many anticipated negative effects have not occurred. The WTO General Council has said that “China has basically completed the commitments and obligations for the first year.”

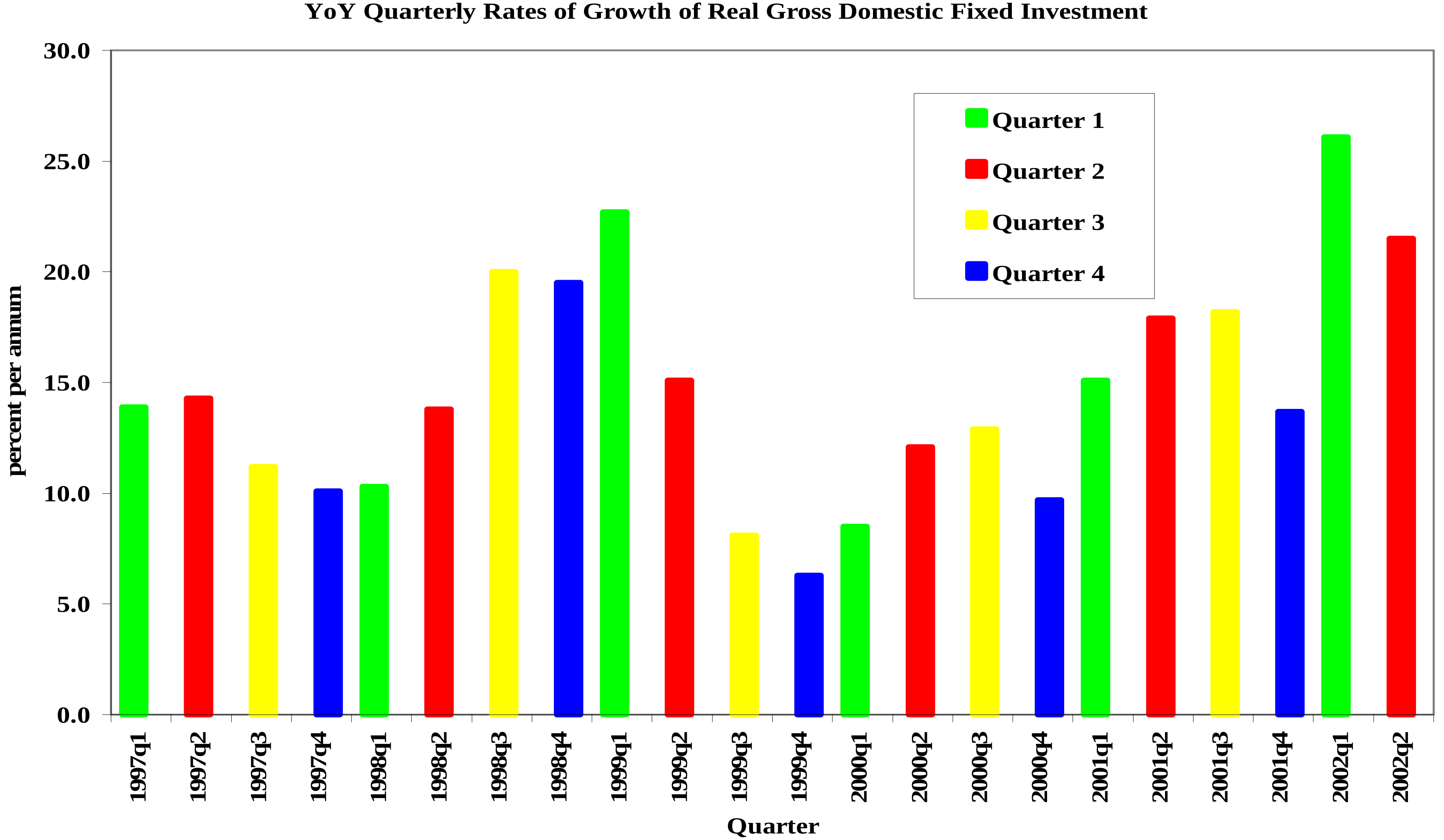
Rates of Growth of Real GDP and Inflation (% p.a.)

		Real GDP	RPI	CPI	
◆ Actual					
	1997	8.8	0.8	2.8	
	1998	7.8	-2.6	-0.8	
	1999	7.1	-2.9	-1.3	
	2000	8.0	-1.5	0.4	
	2001	7.3	-0.8	0.7	
	2002	8.0			
◆ Projections					
	2003	>7.0			(NBS)
		7-8			(DRC)
		7.5		1.0	(Lau)

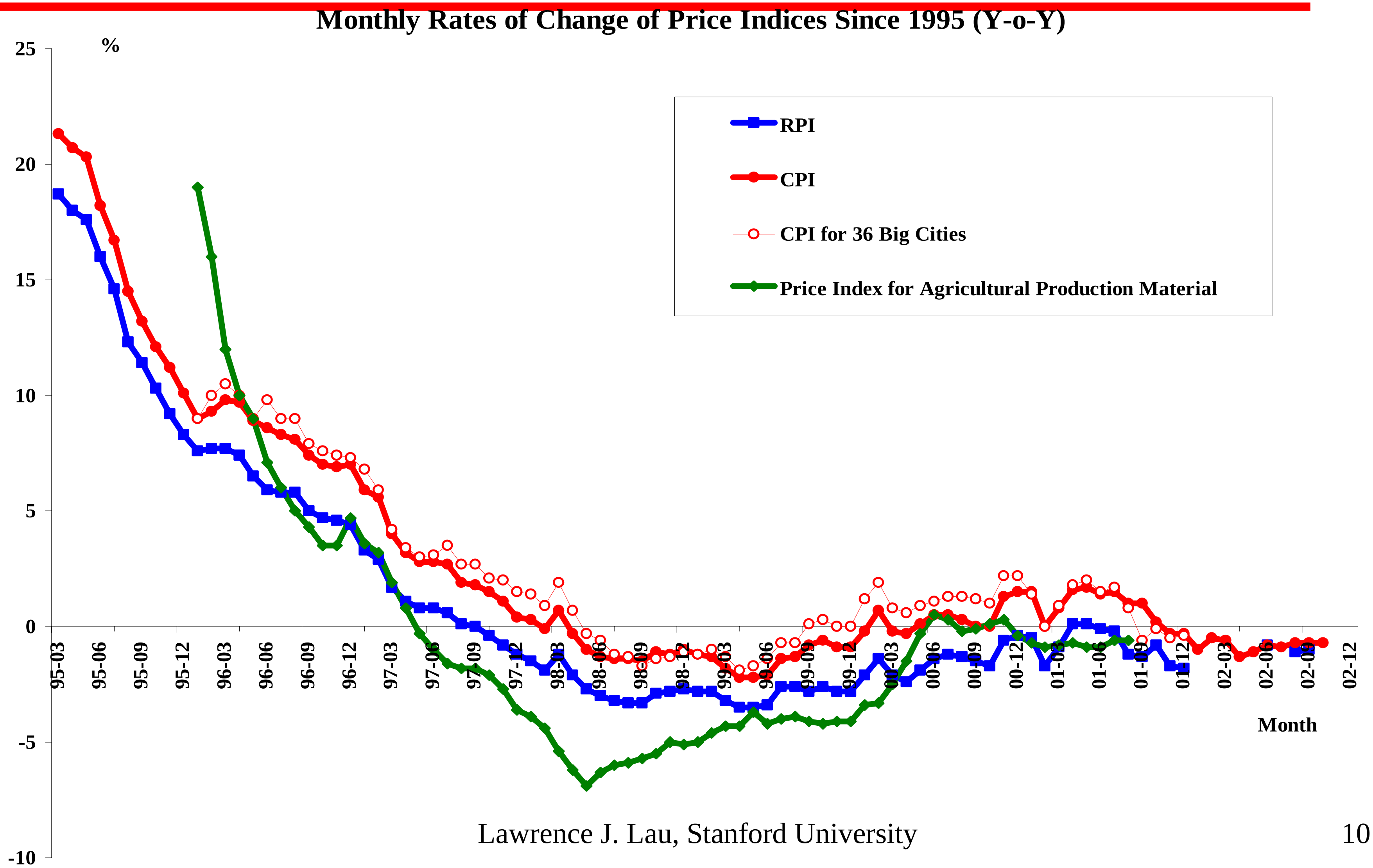
Quarterly Rates of Growth of the Real GDP of the Chinese Economy, Y-o-Y



Quarterly Rates of Growth of the Real Gross Fixed Investment of the Chinese Economy, Y-o-Y



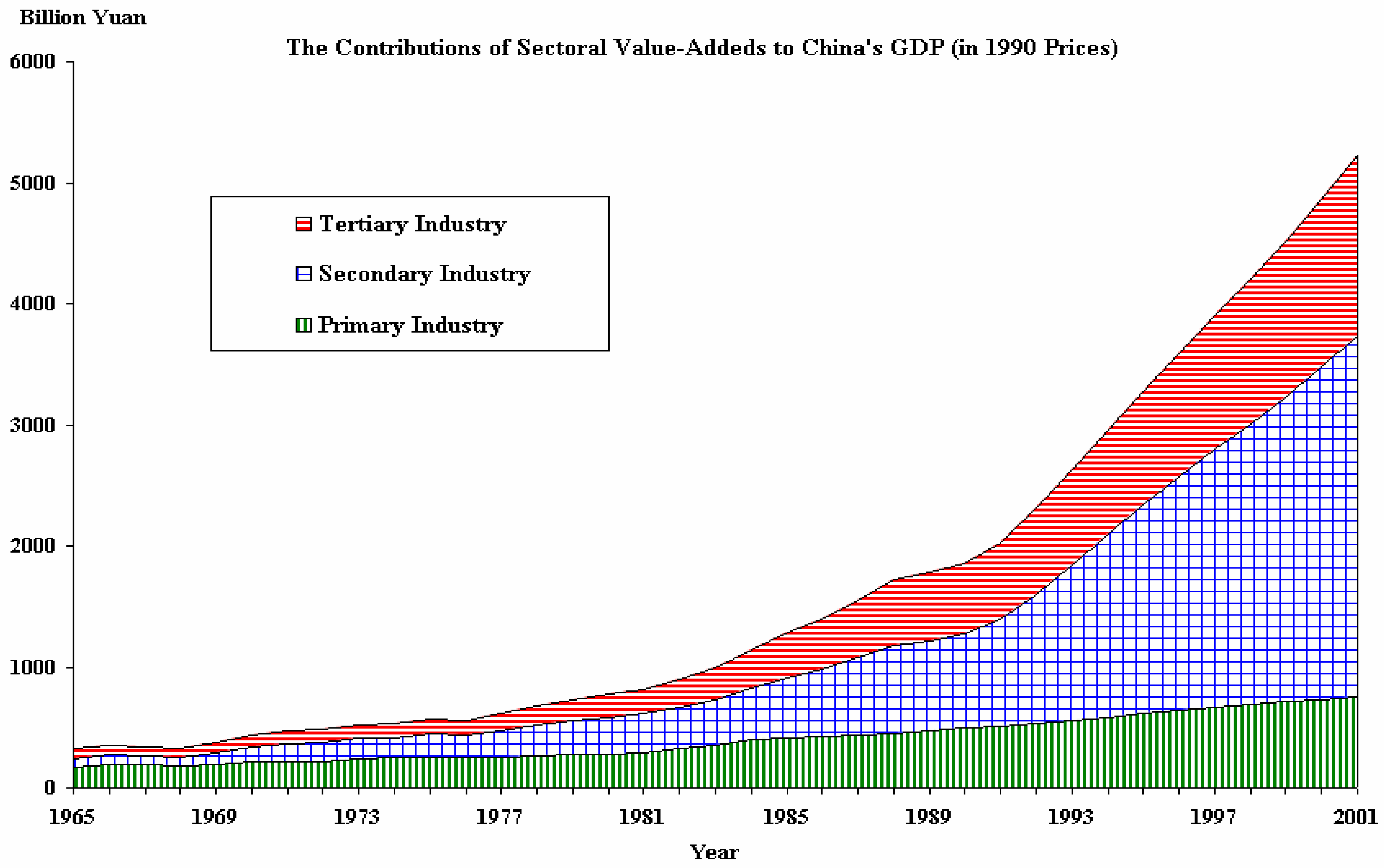
The Consumer and Retail Price Indices



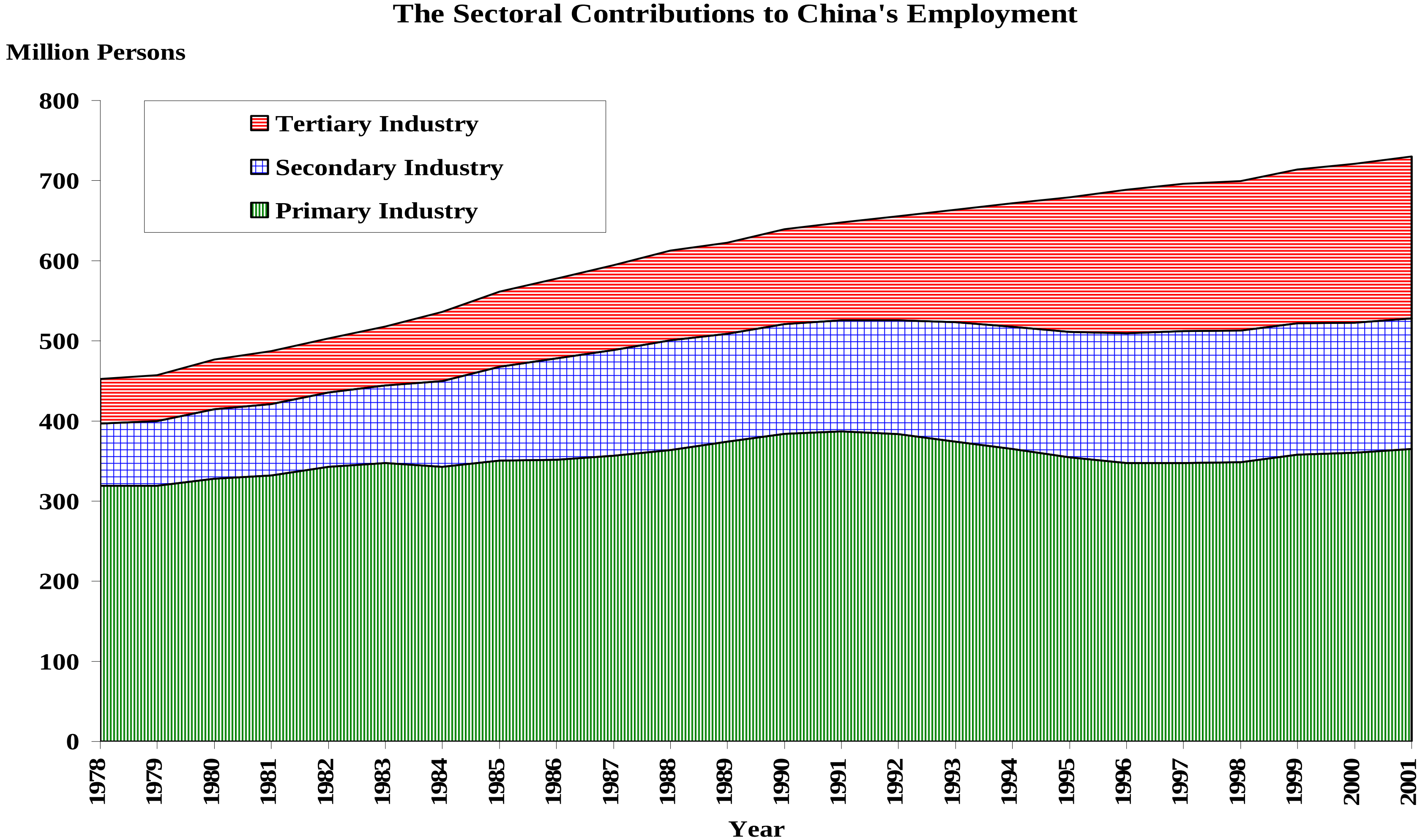
Has “Deflation” Stopped?

- Deflation has slowed. In the first months of 2003 the rate of growth of the consumer price index (CPI) has turned positive.
- The “core” rate of inflation is non-negative
  - The decline in prices over the past few years was due in part to the fall in the prices of energy, in particular oil, and agricultural products, in particular food.
  - It was also due in part to the increase in productivity (reduction in cost) and in competition, the decrease in the degree of monopolistic market power (reduction in profit margin), and more recently by the decrease in prices induced by import tariff reductions mandated by the accession agreement to the WTO.
  - The long-term core inflation rate--inflation rate net of changes in the prices of energy and food--may be estimated at between 0 and 1 percent--there is no deflation.
  - The key to determining whether there is deflation in the classic macroeconomic sense is whether the components of aggregate demand—real consumption and investment—are growing. They have been growing at respectively 10.2% and 16.1% respectively in 2002.

The Contributions of Sectoral Value-Addeds to China's GDP



The Sectoral Contributions to China's Employment



The Stock Market

- Approximately 1223 enterprises (more than 95 percent majority state-owned) listed on Shanghai and Shenzhen Stock Exchanges combined as of year end 2002.
- Market capitalization is US$460 billion, with between 60% and 70% in the form of state-owned, non-circulating institutional shares. The daily market turnover is approximately US$1.5 billion a day.
- Third largest market in Asia after Japan and Hong Kong.
- A-shares for domestic and B-shares for foreign investors; however, beginning in 02/2001, Chinese domestic citizens with foreign exchange can purchase B-shares as well.
- 7/8/99--introduction of indexed funds in China.
- 8/99--16 billion Yuan bonds issued and traded on the domestic stock exchanges.
- 9/99--state-owned enterprises permitted to trade stocks.
- The main boards of the Shanghai and Shenzhen exchanges will be unified in Shanghai.
- A new, second board for non-state-owned enterprises will be set up in Shenzhen with reduced requirements for annual profits and capitalization (Chinese version of the American Stock Exchange).
- The stock listing approval process, whether for IPO or for "back-door listing," has begun to become "ownership blind" in 2002. 27 private enterprises were listed in 2001. The proportion of non-state-owned firms among publicly listed companies is expected to rise.

The Bond Market (1)

- In 2001/05 approximately US$1.5 billion worth of long-term bonds, denominated in US$ and Euro, were sold to international investors.
- The issue was oversubscribed by nearly 5 times.
- The coupon rate on the 10-year US$ bond was 6.8%, 1.33% above U.S. Treasury note of the same maturity.
- The coupon rate on the 5-year Euro bond was 5.25%, 0.64% above German DM bonds of the same maturity.
- The premia paid by the Chinese Government were low by the standards of developing economies.
- These rates were actually higher than the rate of interest paid on Chinese government bonds denominated in Renminbi.
- In 2002/05, thirty-year Yuan-denominated bonds were sold domestically with a coupon rate of 2.9%, indicating very low long-term inflationary expectations.
- In 2002/06, seven-year Yuan-denominated fixed rate bonds were sold to individuals and non-financial institutions at par by the four major state-owned commercial banks at a coupon rate of 2% p.a., indicating extremely low intermediate-term inflationary expectations.
- In 2002/12, 60 billion Yuan worth of 7-year fixed rate bonds were sold with a rate of 2.93%--the issue was oversubscribed 23 times.

The Bond Market (2)

- A record total of US$106 billion of government bonds was sold in 2002. 33 government bonds are listed and traded on the Chinese stock exchanges. However the volume traded on the stock exchanges is only 1/8 of the volume traded on the inter-bank market. The annual turnover on the stock exchanges is approximately US$100 billion.
- In 2003/03, 20 billion Yuan worth of ten-year Yuan-denominated fixed rate bonds were sold with a yield of 2.87% p.a. by the China Development Bank, a state-owned development bank with almost sovereign credit (the expectation is that CDB will issue 350 billion Yuan worth of bonds in 2003).
- The Ministry of Finance is expected to issue 640 billion Yuan worth of bonds in 2003.
- The budget deficit for 2003 has been estimated to be 319.8 Yuan, or approximately 3% of GDP.
- However the bond market suffers from the fact that the only major purchasers are the state-owned banks—the market must be widened and deepened to bring in other institutional and individual investors.
- Multilateral financial institutions, such as the Asian Development Bank, will be allowed to issue Renminbi denominated bonds in the Chinese domestic capital market.

Building a Moderately Well-Off Society by 2020

- The goal of the Chinese Government is a quadrupling of real GDP between 2000 and 2020, implying an average annual rate of growth of real GDP of approximately 7.2%.
- Redressing the imbalance in the economic development between the urban and rural areas, and between the coastal and interior regions.

The Economic Agenda of the New Administration

- Continuation of the twin policies of reform and openness.
- Economic reform to be focused on four areas:
  - Reform of state-own enterprises (separation of the functions of ownership, regulation and supervision, and management)
  - Reform of the financial sector
    - Restructuring of the state-owned banks
    - Enhancing the capital markets
  - Reform of the agricultural sector
  - Reform of the governmental institutions (substitution of indirect macroeconomic control and the market mechanism for direct microeconomic control; enhancement of the social security system)

Tasks Ahead

- Maintaining and increasing employment
- Implementing Chinese commitments under the accession agreement to the World Trade Organization (WTO)
- Establishing a credible and sustainable social safety net
- Reform of the state-owned enterprises (SOEs)
- Reform of the banking and financial systems
- Integrating and unifying the domestic market
- Tackling corruption

Political Uncertainties

- Domestic stability—domestic stability can be maintained as long as the economy performs well and the gap between the have’s and have-not’s does not become too large. The agricultural procurement program, the establishment of the social security fund, the Western Development Initiative, and the renewed focus on education are all intended to address these issues.

The Political Succession

- As expected, it was smooth and as predicted (no surprises).
- Young technocrats will be moving up to ministerial ranks.
- Economically, the policy of reform and liberalization will continue—the objective is to quadruple Chinese real GDP by 2020, to not quite US$5 trillion in 2002 prices, or less than a third of then expected U.S. real GDP. Real GDP per capita is expected to be just short of US$3,500 in 2002 prices, compared to a projected U.S. real GDP per capita of approximately US$50,000.
- Politically, there will be efforts on the part of the Chinese Communist Party to recruit new members from all walks of life and not just from the peasants and the proletariat (the "Three Represents").
- Diplomatically, the policy of a low international profile will also be continued; there will also be increased efforts to strengthen the ties between the PRC and the other East Asian countries, both diplomatically and economically—e.g., The China-ASEAN Free Trade Area.

Impact of the Entry of China into the World Economic System

- The impact of the fluctuations in the world economy on China
- The world’s factory and the world’s market
- Large domestic markets as potential platforms for new alternative technologies and standards
- Lack of upward pressure on the wage rate of unskilled labor
- Economic integration of East Asia
  - Free Trade Areas
  - Co-operation among currencies and eventually approximately fixed parities

The Relative Stability of the Rate of Growth of Real GDP

- Gross domestic investment is mostly financed through domestic savings rather than foreign investment or loans.
- Foreign direct investment (FDI) accounts for approximately 10% of gross domestic investment in China, a relatively small proportion.
- Despite fluctuations in exports and imports, the rate of growth of real GDP has remained remarkably stable at 7-8%. Exports are approximately 25% of GDP, but the value-added component is only approximately 30%, resulting in an export-generated value-added to GDP ratio of 7.5%. Chinese exports to the U.S. is approximately 8% of Chinese GDP (according to adjusted U.S. data), with a value-added content of 20%, resulting in a value-added to GDP ratio of 1.6%.
- The volatility of the Chinese annual rates of growth has also declined, indicating an improved capacity for macroeconomic management.
- The contribution of net exports of goods and services to the economic growth of 2002 is approximately 1%. The rate of growth of real fixed investment is 16.1%; the rate of growth of real consumption is 10.2%. (In 2003/M1-2, real fixed investment increased 33% YoY.)

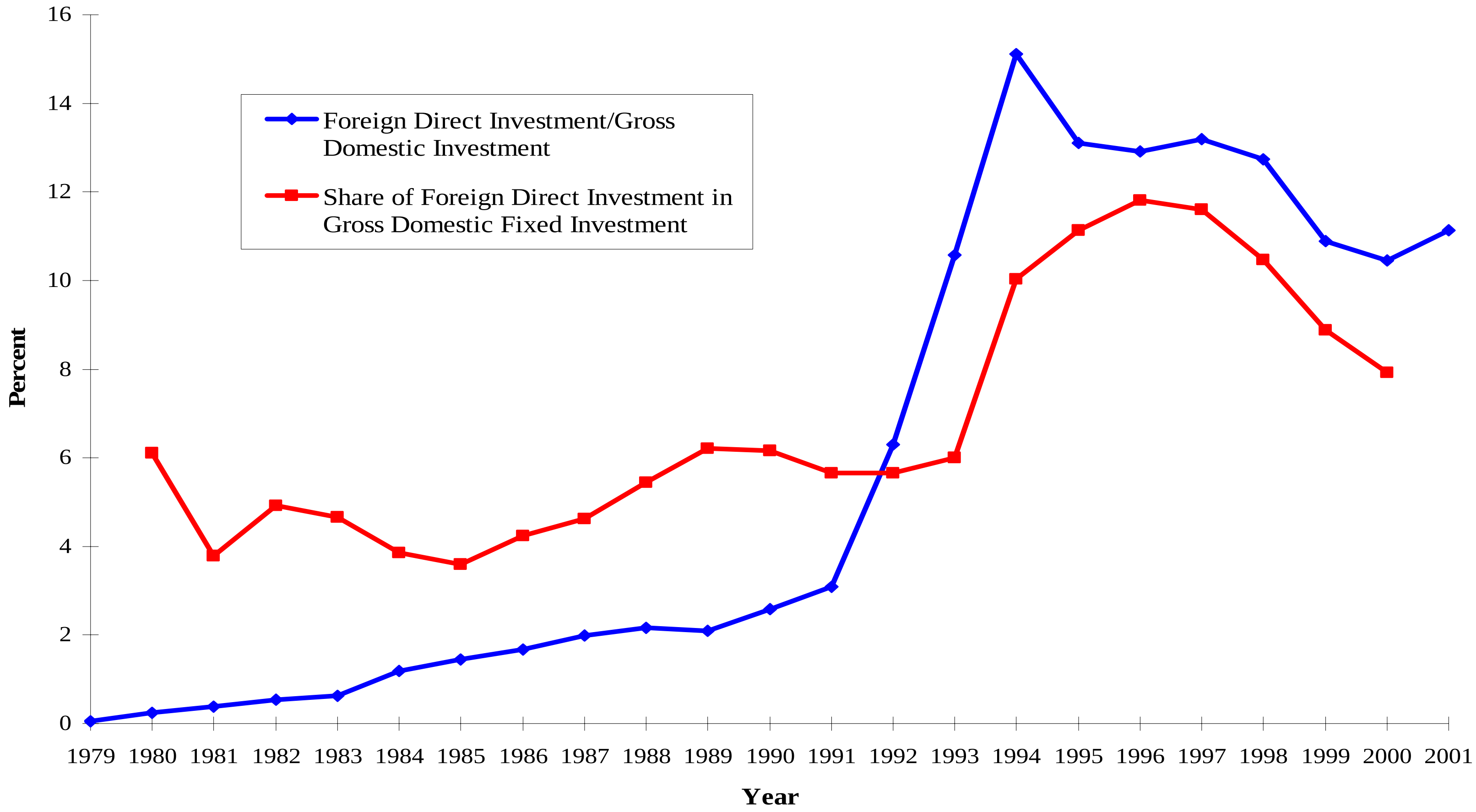
Foreign Direct Investment (FDI)

- FDI, at US$50 billion a year, amounts to approximately 10% of the annual Chinese aggregate gross domestic investment of approximately US$500 billion. Moreover, a significant proportion of it is what is known as "recycled" or "round-tripped" investment ultimately originated by Chinese entities and individuals. Quantitatively, FDI is not critical to the Chinese economy.
- Qualitatively, FDI is probably more important because it brings in technology, know-how, business methods, management techniques and markets that will otherwise be unavailable in China.
- In 2001, China is the fourth largest recipient country of FDI, behind the United States, the United Kingdom and Sweden, accounting for approximately 5% of worldwide FDI.
- China became the World's leading recipient of FDI for the first time in 2002, with US$52.7 billion, overtaking the United States with approximately US$44 billion. However, its share of total World FDI is still relatively low—approximately 10%. (The U.S. was the largest recipient of FDI in the world in 2001, with US$124 billion.)
- FDI has been responsible for most of the growth of exports (and imports). However, the nature of FDI has also changed--from export-oriented to domestic-market oriented; from light industry to heavy and high-technology industries; and from small projects to large projects.

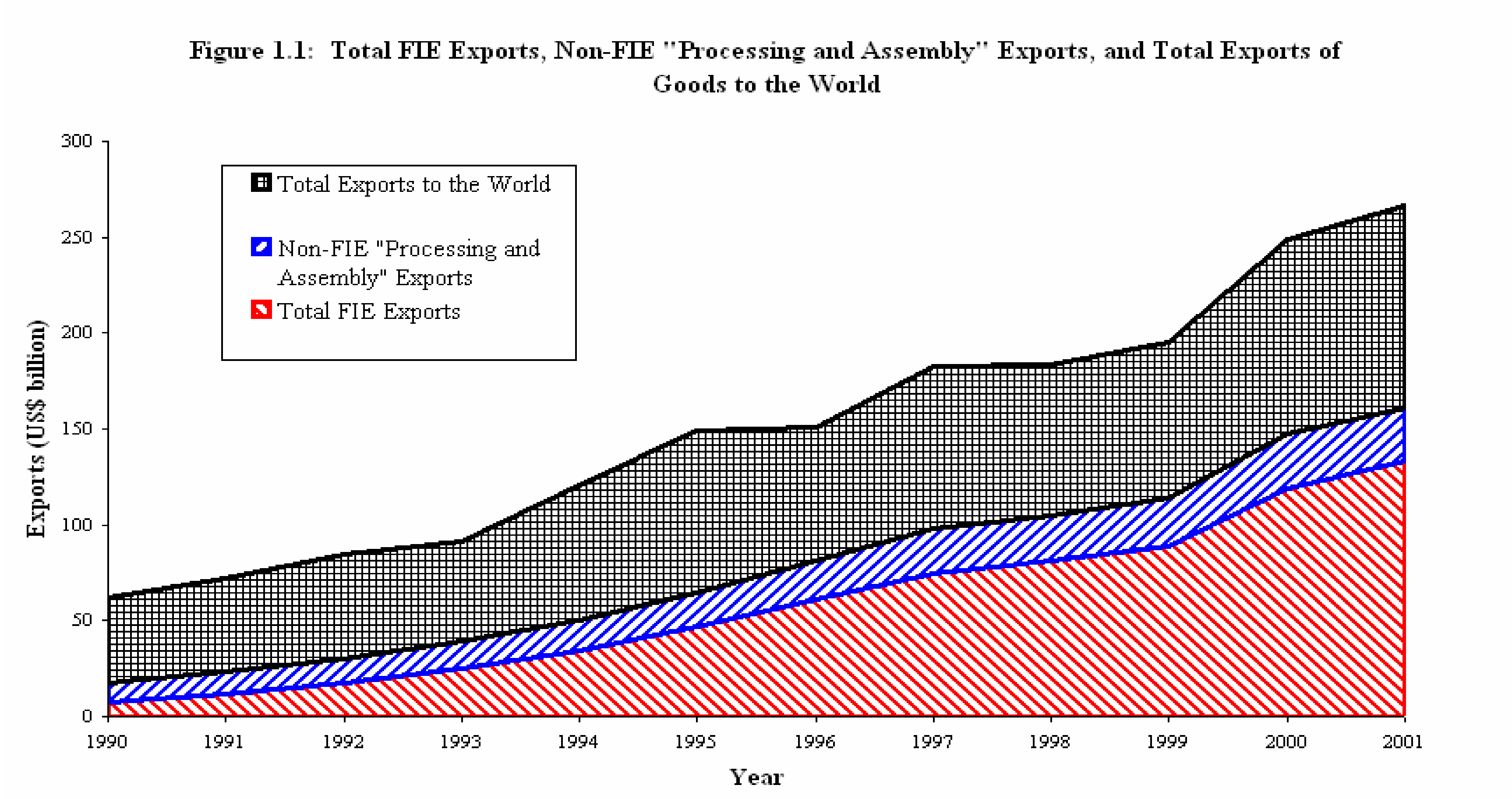
China’s FDI as a Percent of Gross Domestic Investment

The Shares of FDI in Chinese Gross Domestic and Gross Domestic Fixed Investment

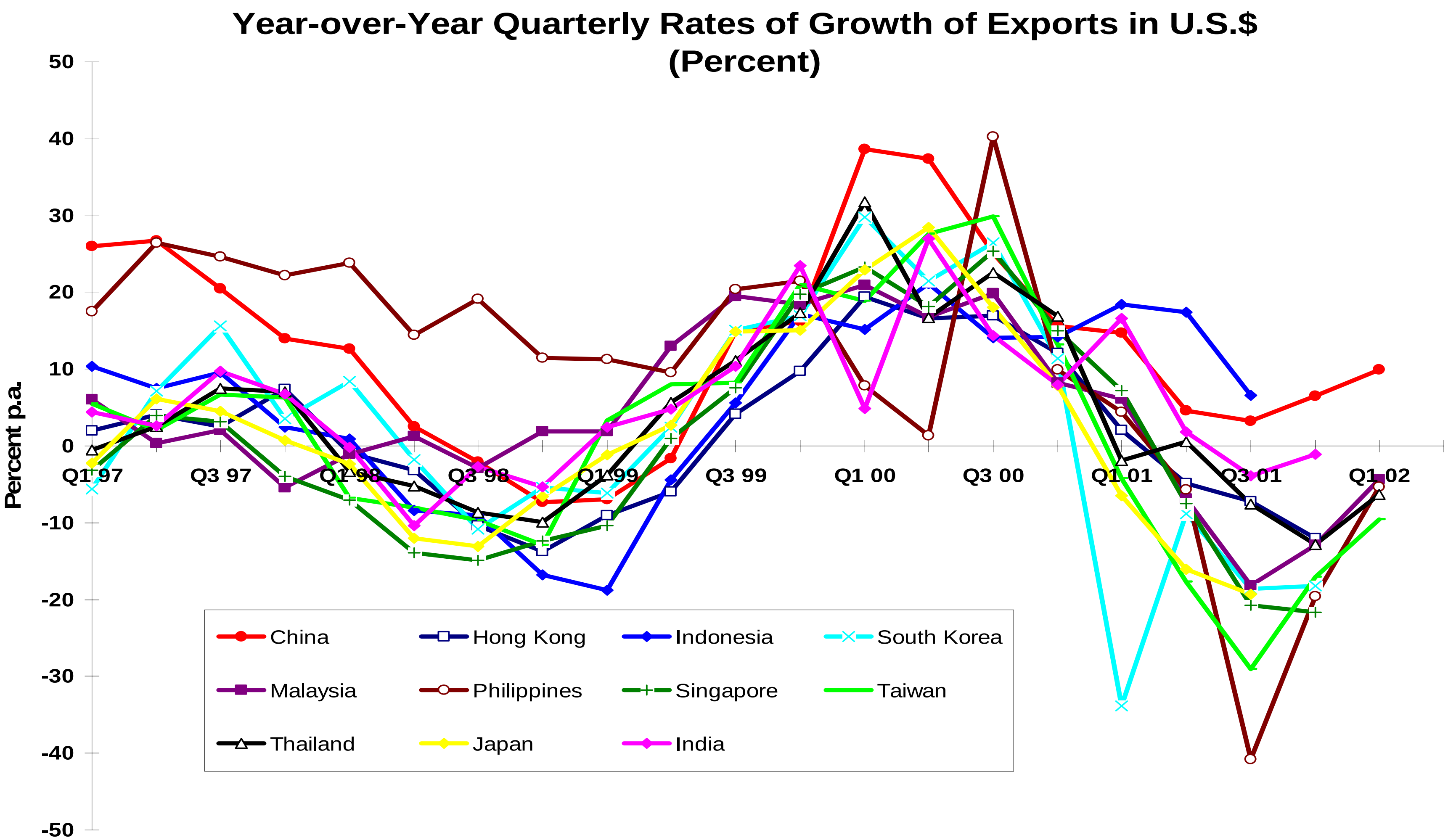
Fig. 1.2. The Share of Foreign Direct Investment in China (Percent)



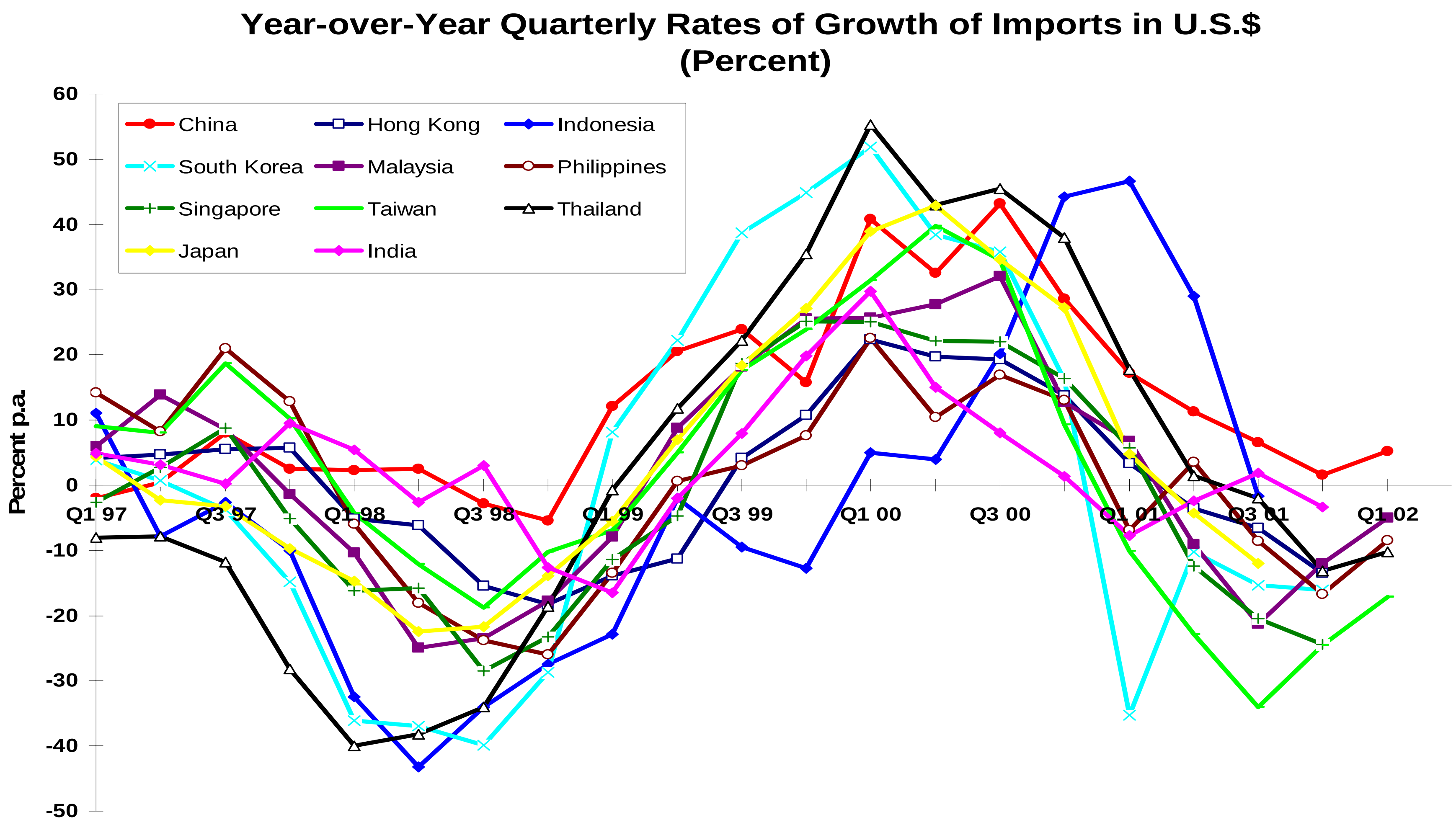
Chinese Total, Foreign-Invested Enterprises (FIEs) and Non-FIE "Processing and Assembly" Exports



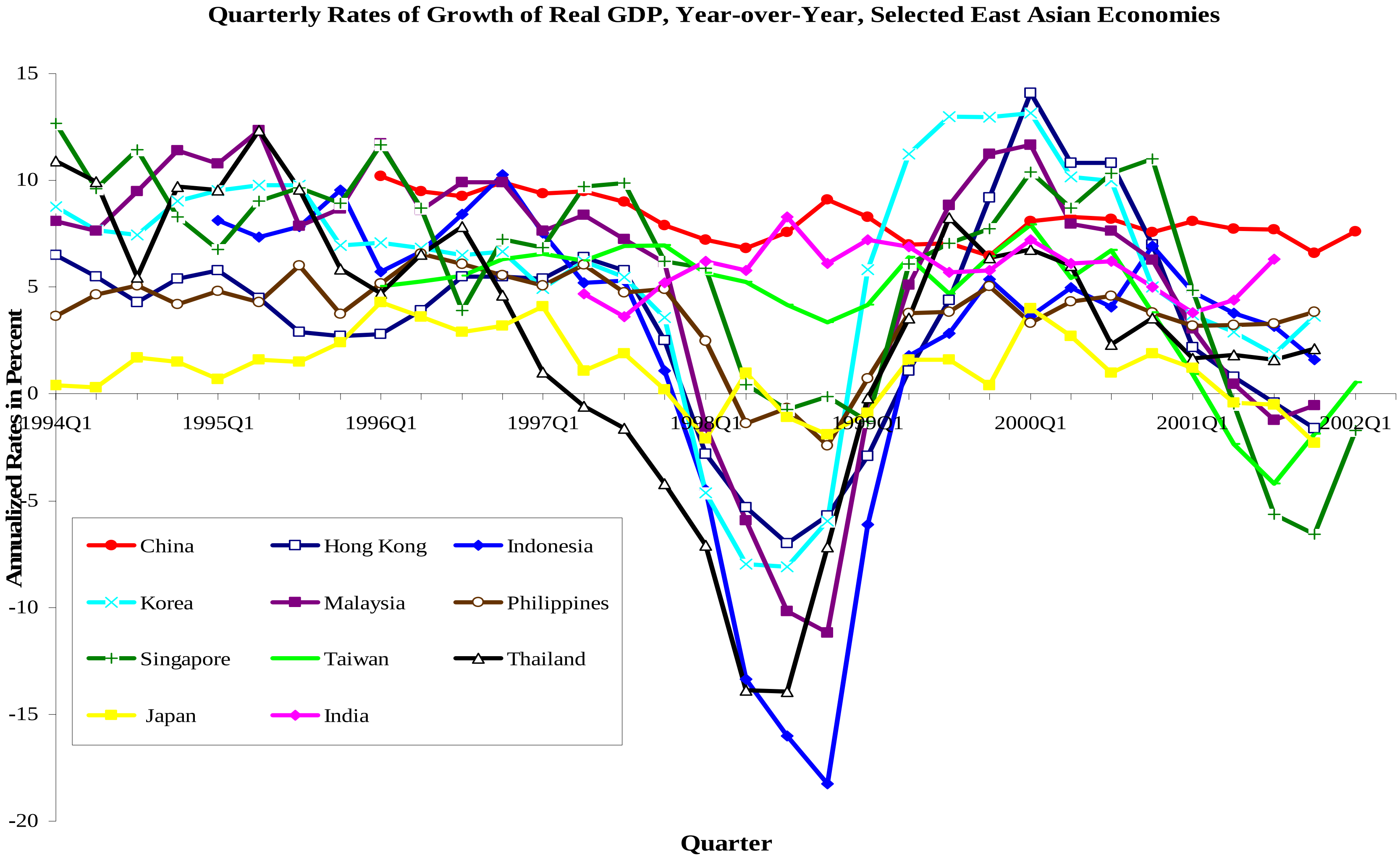
Quarterly Rates of Growth of Exports: Selected East Asian Economies



Quarterly Rates of Growth of Imports : Selected East Asian Economies

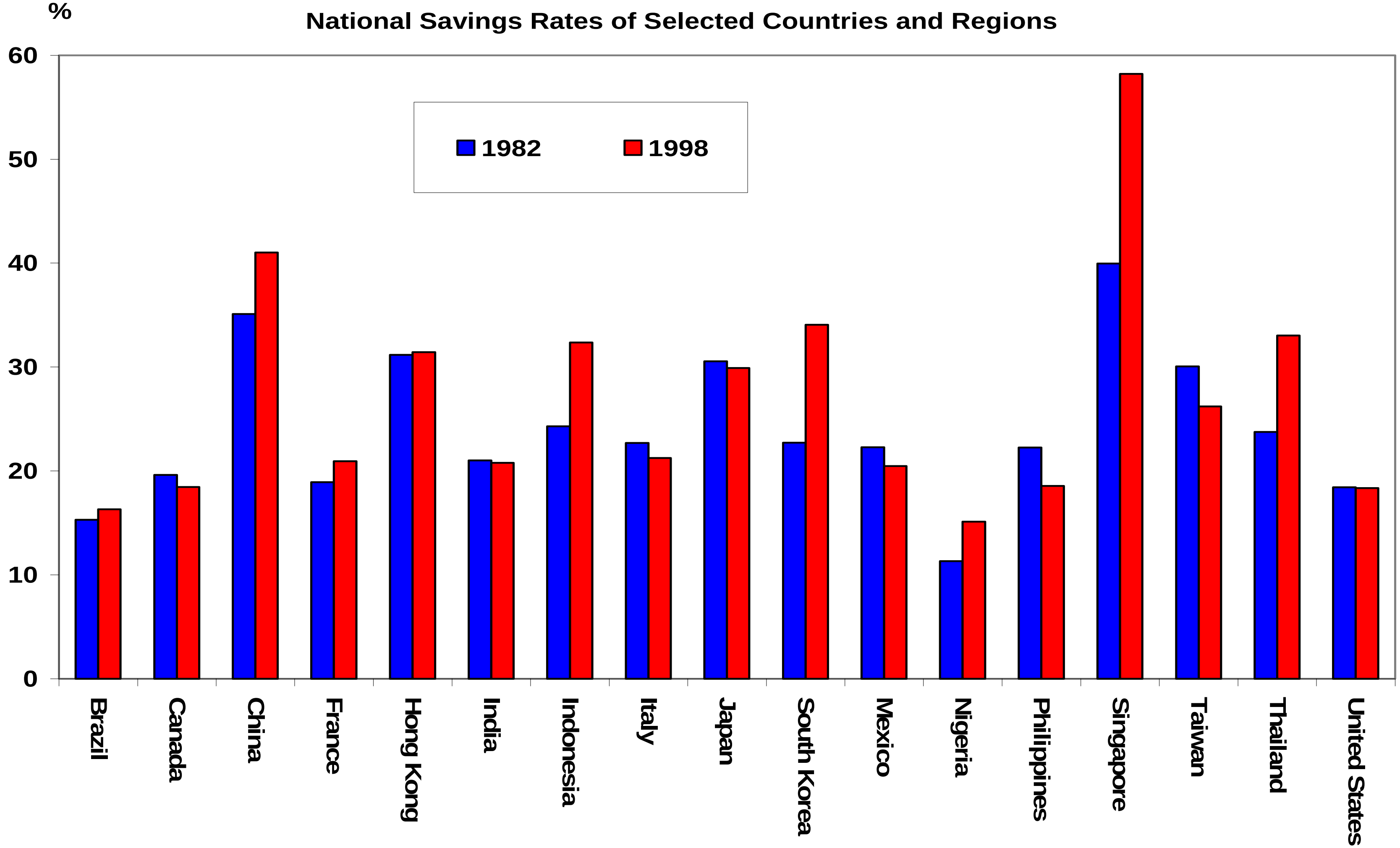


Quarterly Rates of Growth of Real GDP: Selected East Asian Economies

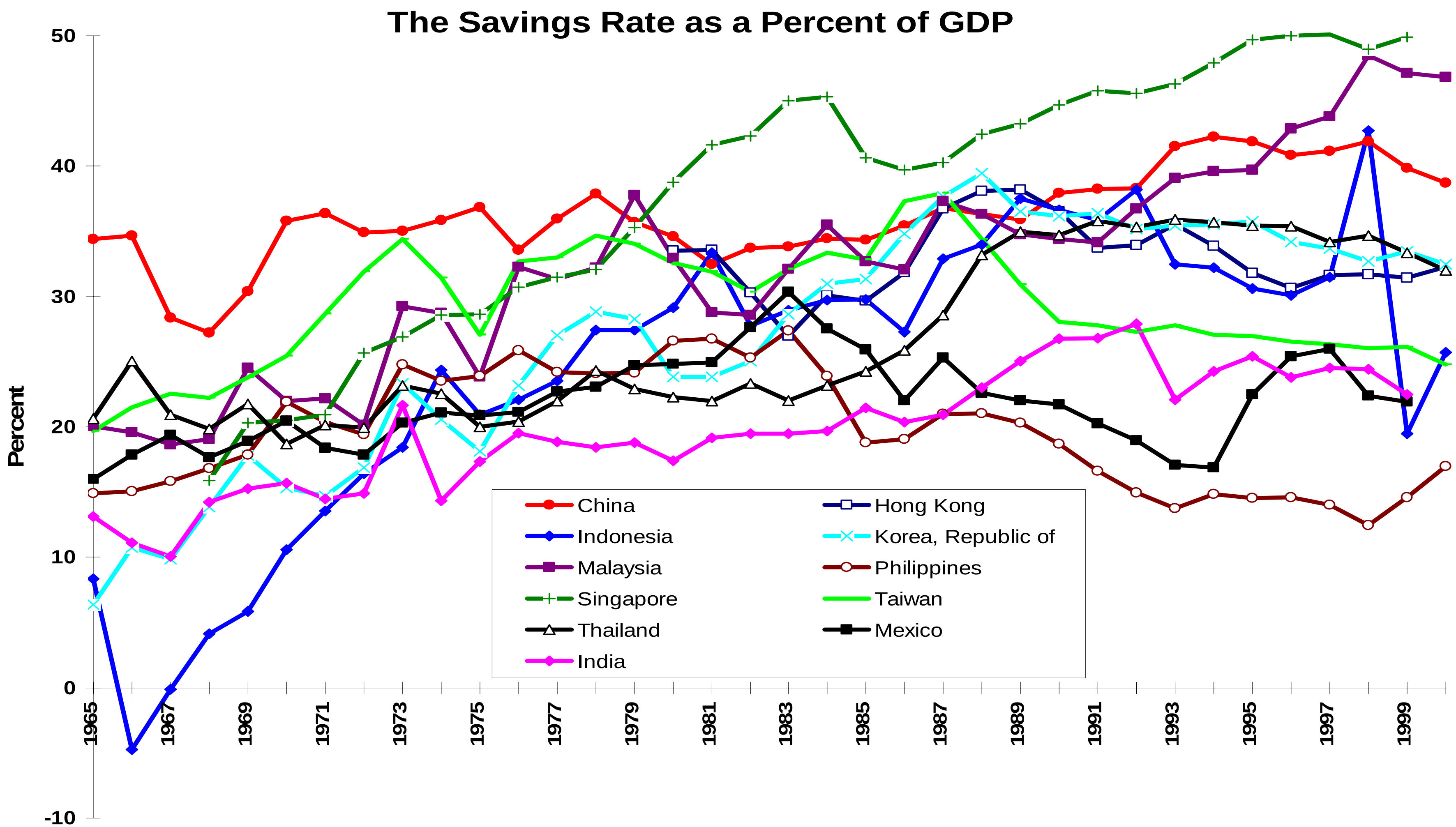


China's Gross Domestic Investment as a Percent of GDP

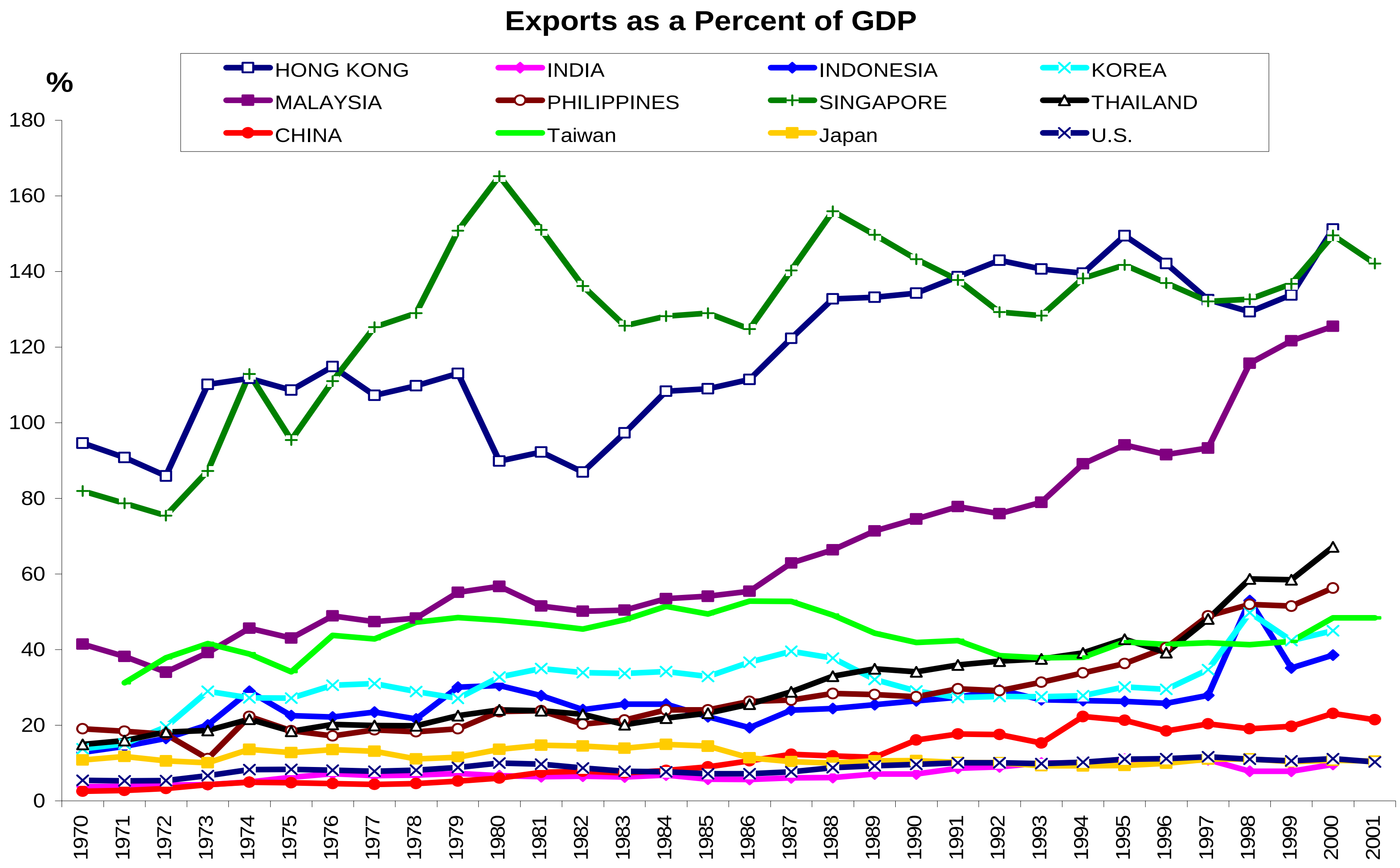
National Savings Rate as a Percent of GDP: Selected Countries and Regions



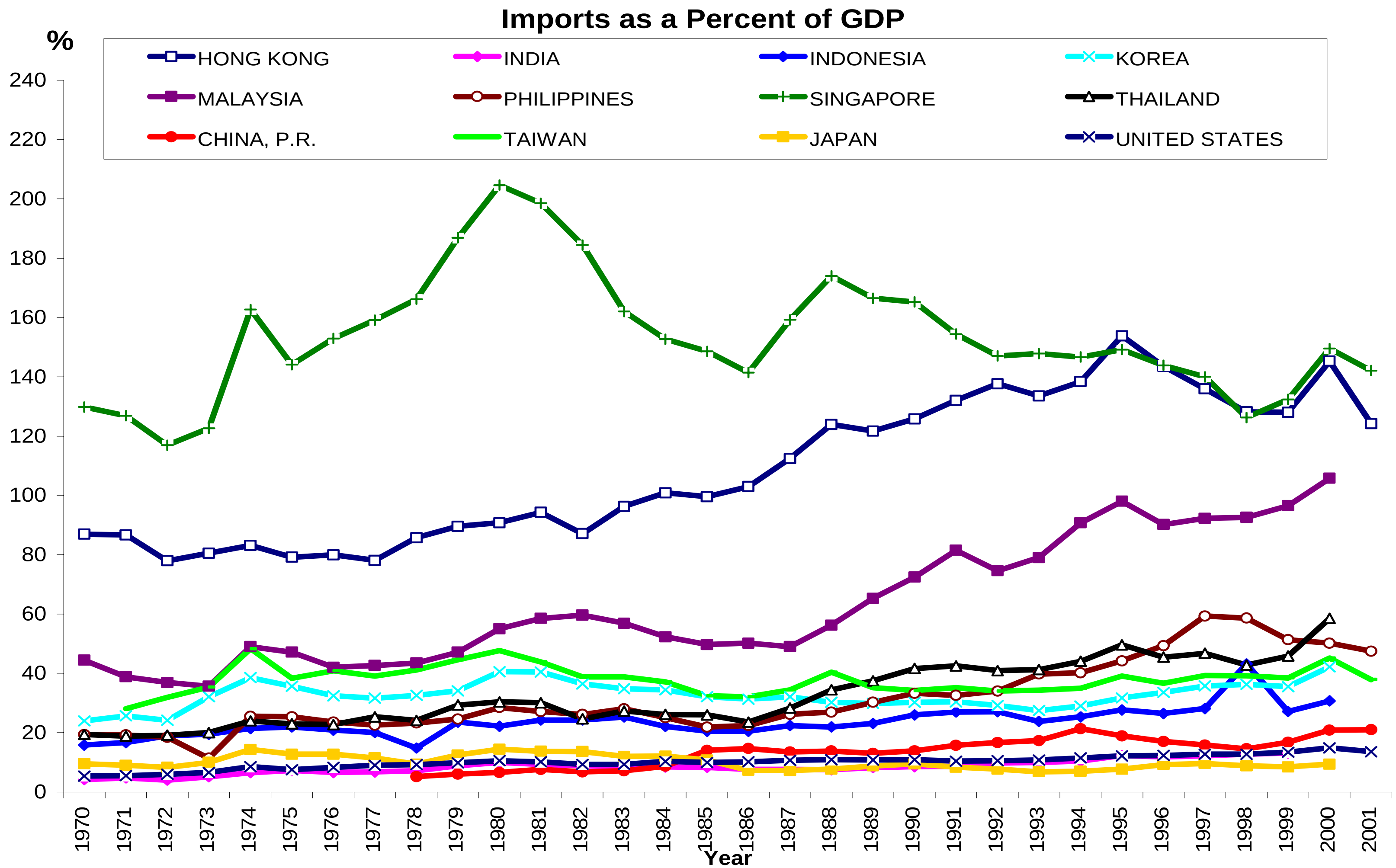
The Savings Rate as a Percent of GDP: Selected East Asian Countries and Regions



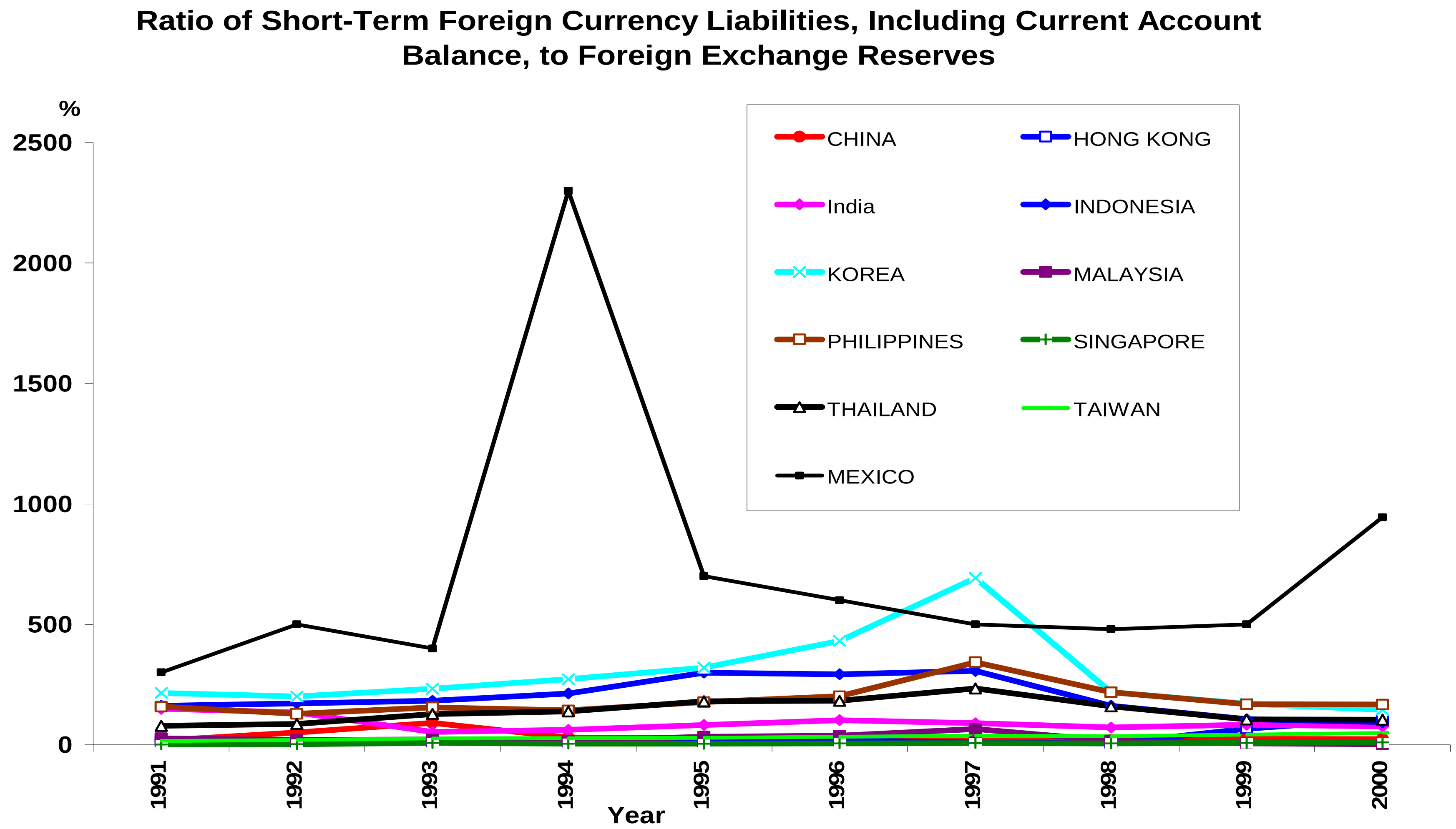
Exports as a Percent of GDP: Selected East Asian Economies and U.S.



Imports as a Percent of GDP: Selected East Asian Economies and U.S.



Ratio of Liquefiable Foreign Exchange Liabilities, Including Current Account Balance, to Reserves



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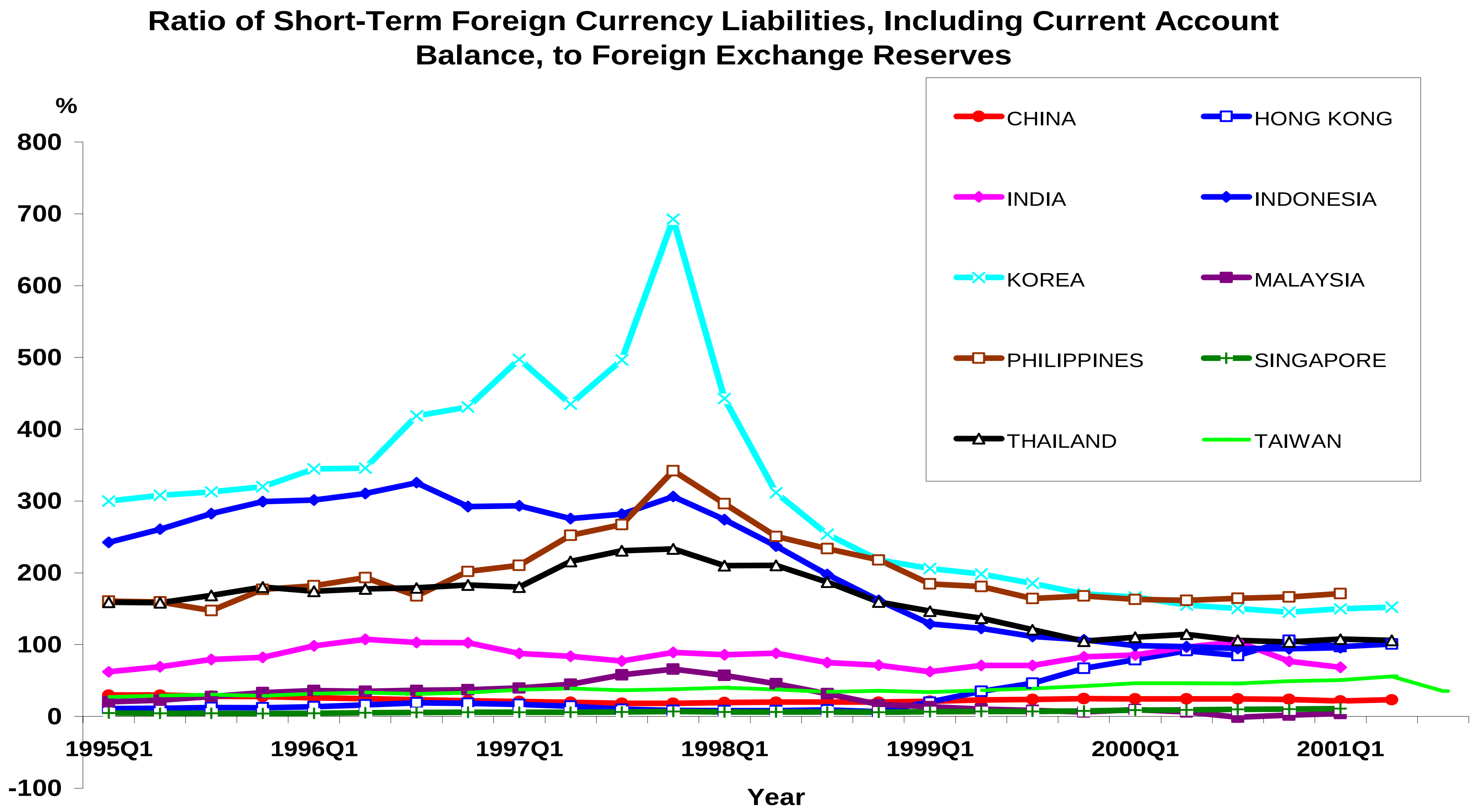


The Entry of New Players on the Global Market (China, India and Russia)

- Re-alignment of comparative advantages
  - Both existing and new players can benefit
  - Comparative advantages will change
  - Adjustments will be necessary
  - There should be sufficient gain for everyone to more than compensate all the losers
- There will be increased demands for goods and services (capital goods, intermediate goods, aircrafts, cell phones, computers and tourism services, raw materials and natural resources). China is expected to become Asia's leading importer by 2005, with much of the imports originating from East Asian economies.
- There will be little upward pressure on the real wage rate of unskilled labor for many years to come, which in turn implies that there will be little upward pressure on prices.

The Challenge of the Chinese Economy

- China is more complementary than competitive to Japan, South Korea and Taiwan on the one hand and to the ASEAN countries on the other. There is relatively little overlap in the goods exported by China and the goods exported by the first group of economies. There is some overlap between the goods exported by China and those exported by the ASEAN countries, mainly in low-cost light manufactured goods. However, the ASEAN countries have the capacity to export primary products and raw materials whereas China is a net importer of primary products and raw materials.
- Mainland China presents an opportunity because of its own vast domestic market, and because of its almost unlimited supply of low-cost labor—it is thus not only an export base, but a market in itself

The Challenge of the Chinese Economy

- The large and rapidly growing domestic market enables the realization of economies of scale, and the possibility of amortization of significant investments in innovation and brand name building, standard setting, and other forms of intangible capital. E.g. Kangsifu's success in brand building in the Mainland; Acer could have become No. 1 on the Mainland; Mainland China is potentially a large enough market for Linux-based software to challenge the Windows operating system of Microsoft; and for a global mobile phone standard to emerge--GSM of Europe versus CDMA of the U.S. versus the TDCDMA of China itself; and for determining the relative success of Airbus versus Boeing.
- Leading firms in the world cannot afford to leave a large and rapidly growing potential market alone because a large enough market may nurture in time a major competitor.
- Taiwan firms have a comparative advantage over the firms of other countries and regions because of cultural, ethnic and linguistic affinities.

The ASEAN Free Trade Area (AFTA)

- Intra-ASEAN tariff rates have been lowered to 5% on Jan. 1, 2002 with the inauguration of the ASEAN Free Trade Area (AFTA) among Brunei, Indonesia, Malaysia, Philippines, Singapore and Thailand. The goal is to reach zero tariff rate within AFTA by 2010. The reduction in tariffs applies to 90% of products provided the ASEAN content of the product exceeds 40%.
- Khmer Republic, Laos, Myanmar and Vietnam are expected to join AFTA in 2006 and reach zero tariff rate within AFTA by 2015.
- Specific protection on manufactured and agricultural products still remains.

The China-ASEAN Free Trade Area

- Chinese Premier ZHU Rongji first proposed in Brunei in November, 2001 a new free trade area, covering China and the ASEAN (Brunei, Indonesia, Khmer Republic, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam), to be created within ten years.
- A 3 trillion US$ market and 1.7 billion consumers.
- Complementarity (primary raw materials) and competition (light manufactures).
- Opening the economies for trade—China will become a major export market for the ASEAN and vice versa.
- The free trade area will promote foreign direct investment in the ASEAN region itself through the enlargement of the potential market.
- Further agreement was reached in a second meeting in Phnom Penh, Khmer Republic in November, 2002 at which a framework agreement for the establishment of the China-ASEAN Free Trade Area was signed.
- Negotiations to be completed by 2004 with "early harvest" for ASEAN countries in the reduction of tariffs on agricultural and food products. Full free trade between China and Brunei, Indonesia, Malaysia, Philippines and Singapore by 2010; full free trade extended to Khmer Republic, Laos, Myanmar and Vietnam by 2015.

The China-ASEAN Free Trade Area

- A mutual support program for the currencies of one another, leading possibly to an Asian currency snake, and eventually an Asian currency area.
- Simultaneous, coordinated expansions among the East Asian economies can accelerate the economic growth of one another.
- The China-ASEAN Free Trade Area and other parallel initiatives such as the Mekong River Project and security cooperation with the ASEAN countries have significant diplomatic, political and security implications

Prospects for Future Economic Growth

- Input-Driven versus Innovation-Driven
- The Three Paradigms of Economic Growth
- The Development of the "Great West"
- The New Economy and the Possibility of Leap-Frogging
- The Problems and Uncertainties

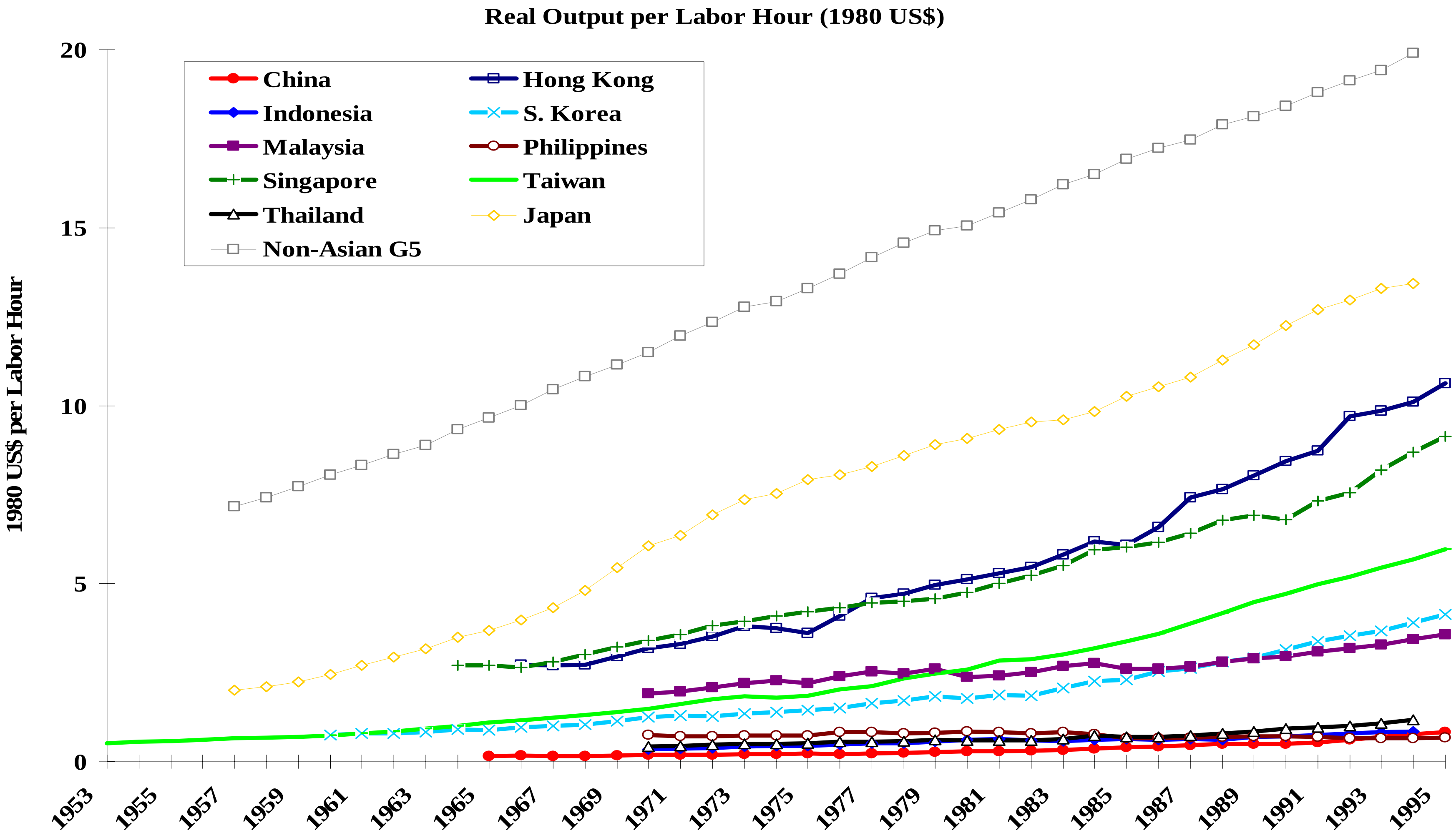
The Sources of Economic Growth: Findings of Kim & Lau As Reported by Krugman (1994)

- Using data from the early 1950s to the late 1980s, Kim and Lau (1992, 1994a, 1994b) find that:
- (1) No technical progress in the East Asian NIEs but significant technical progress in the industrialized economies (IEs)
- (2) East Asian economic growth has been input-driven, with tangible capital accumulation as the most important source of economic growth (the latter applying also to Japan)
  - Working harder as opposed to working smarter
- (3) Technical progress is the most important source of economic growth for the IEs, followed by tangible capital, accounting for over 50% and 30% respectively, with the exception of Japan
  - NOTE THE UNIQUE POSITION OF JAPAN!
- (4) Technical progress is purely tangible capital-augmenting and hence complementary to tangible capital
- (5) Similar results are obtained when China and the ASEAN countries of Indonesia, Malaysia, Philippines and Thailand are included in the sample.

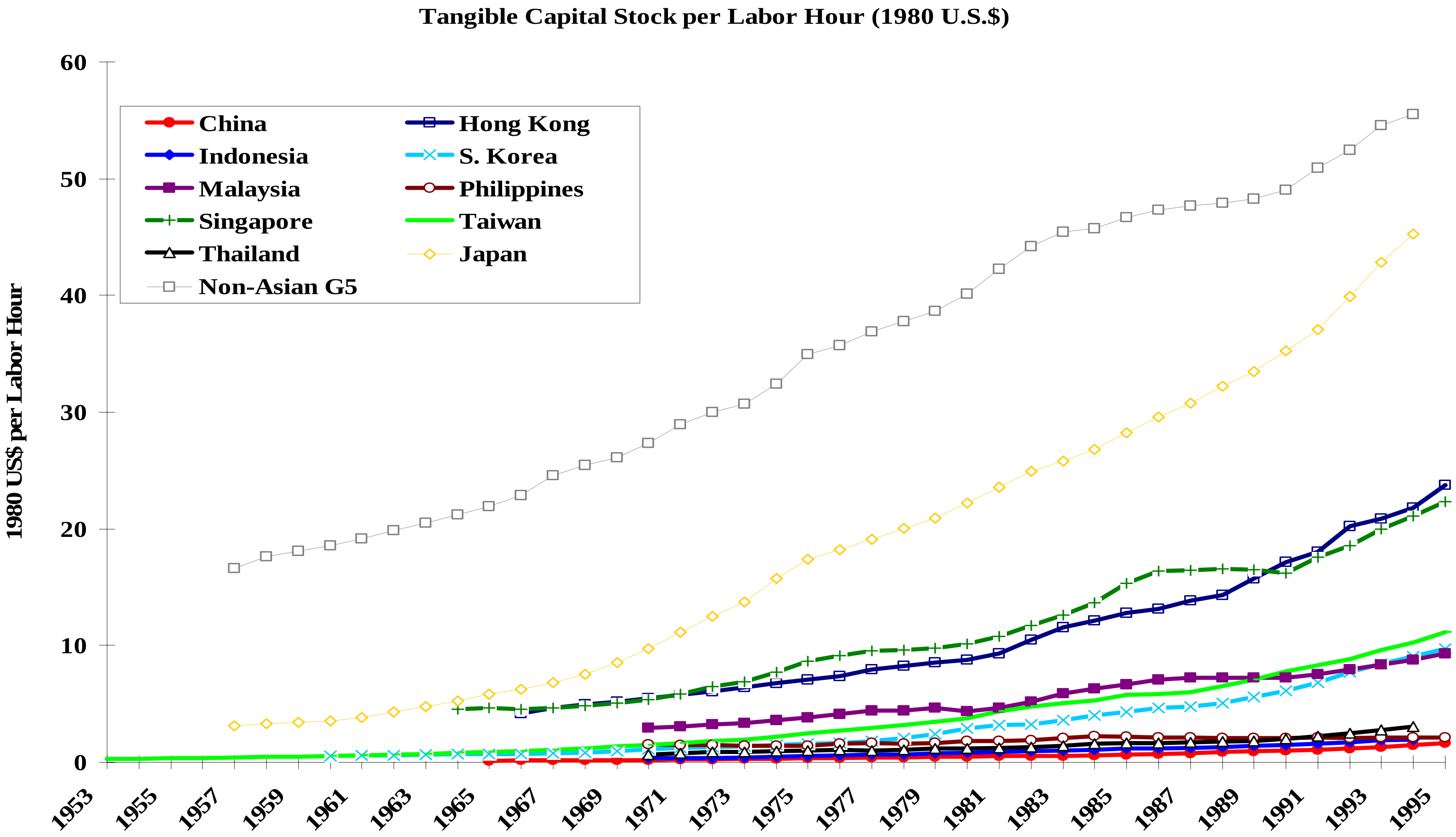
The Sources of Economic Growth--Developing Economies in East Asia

- Different types of measured inputs play different roles at different stages of economic growth
- Tangible capital accumulation is the most important source of growth in the early stage of economic development
- But simply accumulating tangible capital is not enough--it must also be efficiently allocated
- Efficient tangible capital accumulation is the major accomplishment of the East Asian NIEs in the postwar period
  - Market-directed allocation of new investment, aided by export orientation, promotes efficiency
  - Private enterprises have the incentives for prompt self-correction
- Intangible capital accumulation becomes important only after a certain level of tangible capital per worker is achieved but has begun to be important for some East Asian NIEs such as South Korea and Taiwan

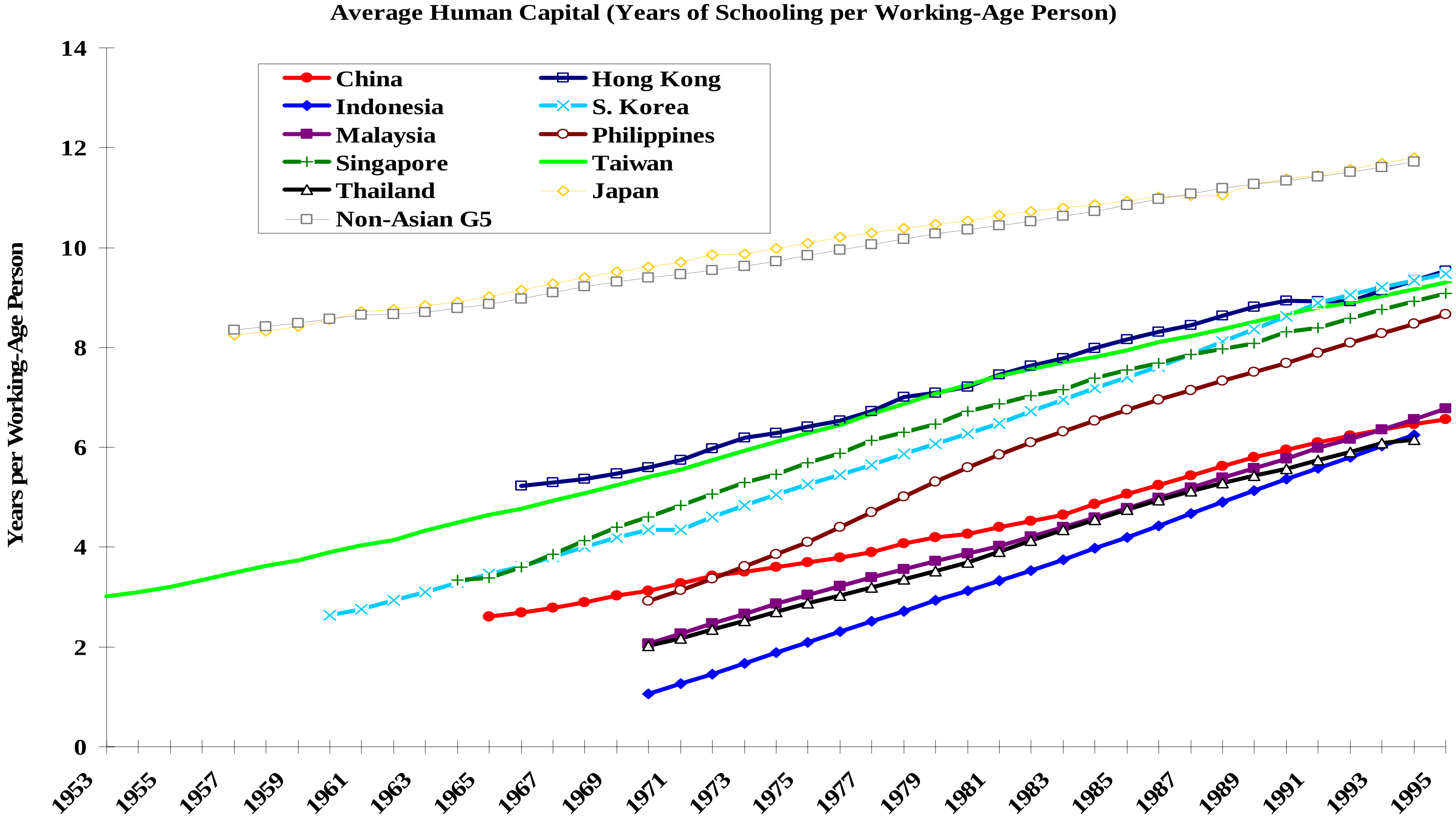
Real Output per Labor Hour (1980 US$)



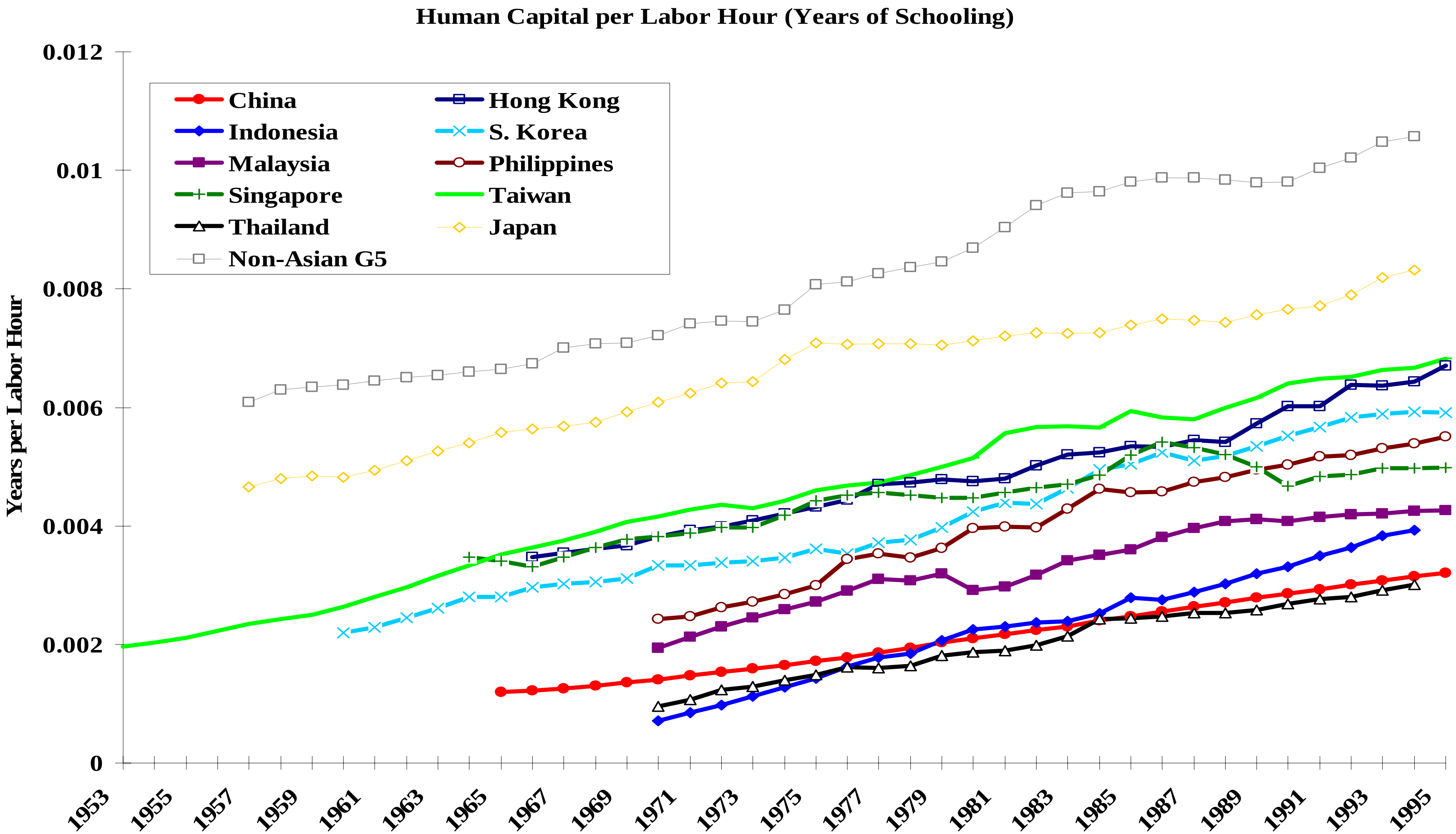
Tangible Capital Stock per Labor Hour (1980 US$): Selected Economies



Average Human Capital (Years/Working-Age Person: Selected Economies)



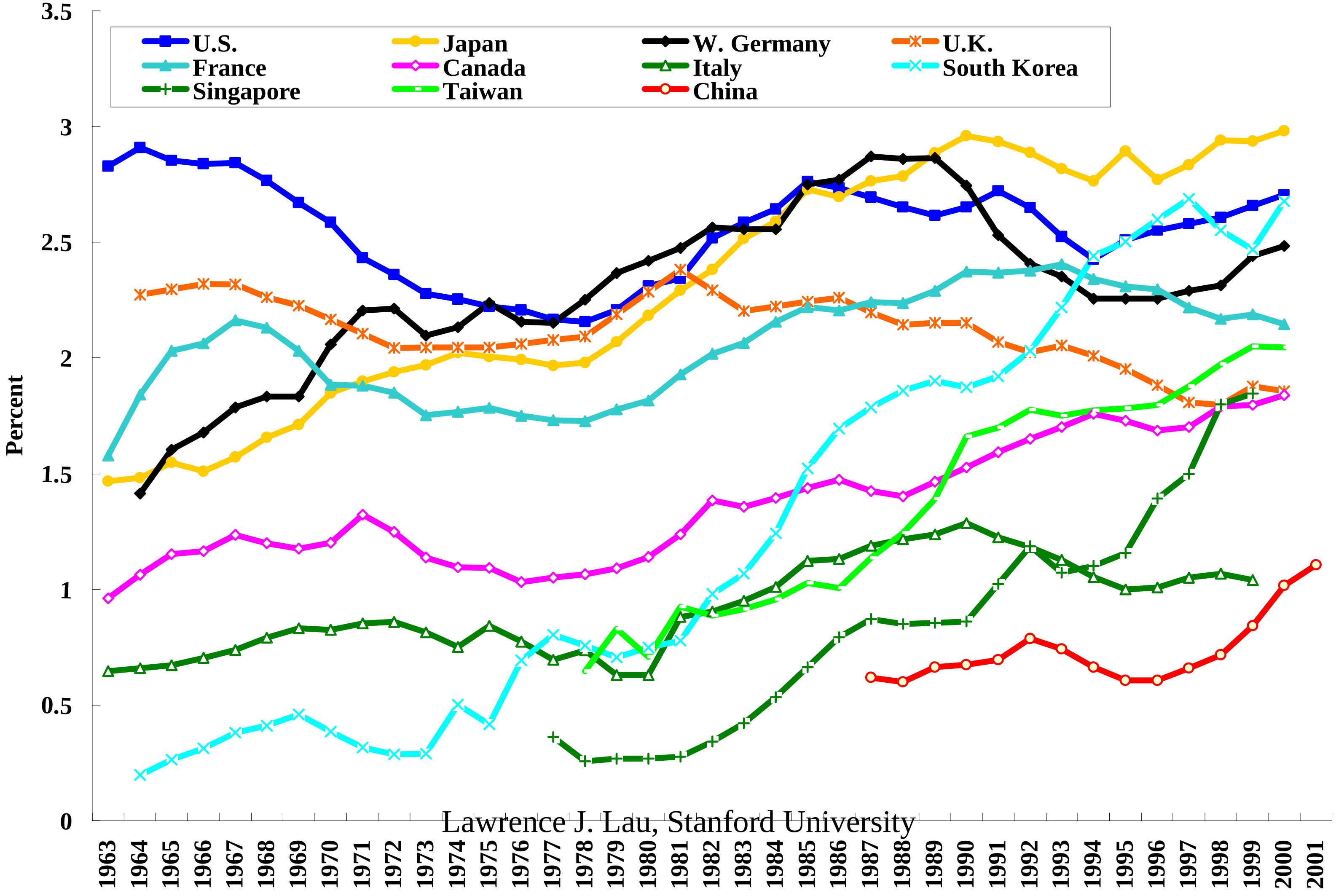
Human Capital per Labor Hour (Years of Schooling): Selected Economies



R&D Expenditures: China

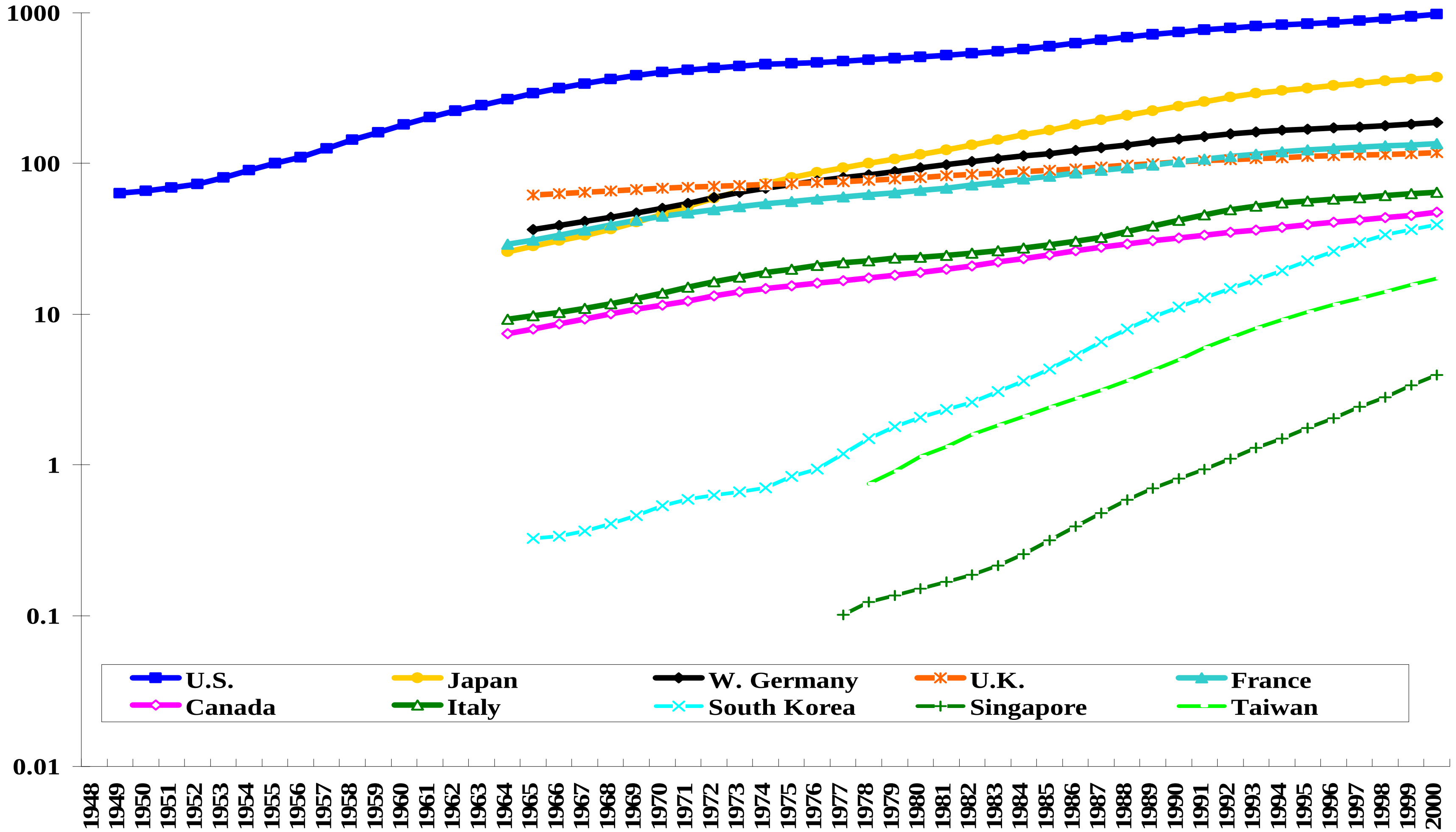
R&D Expenditures as a Ratio of GDP: G-7 Countries, 3 East Asian NIES & China

Figure 8.1: R&D Expenditures as a Percentage of GDP: G-7 Countries, 3 East Asian NIEs and China

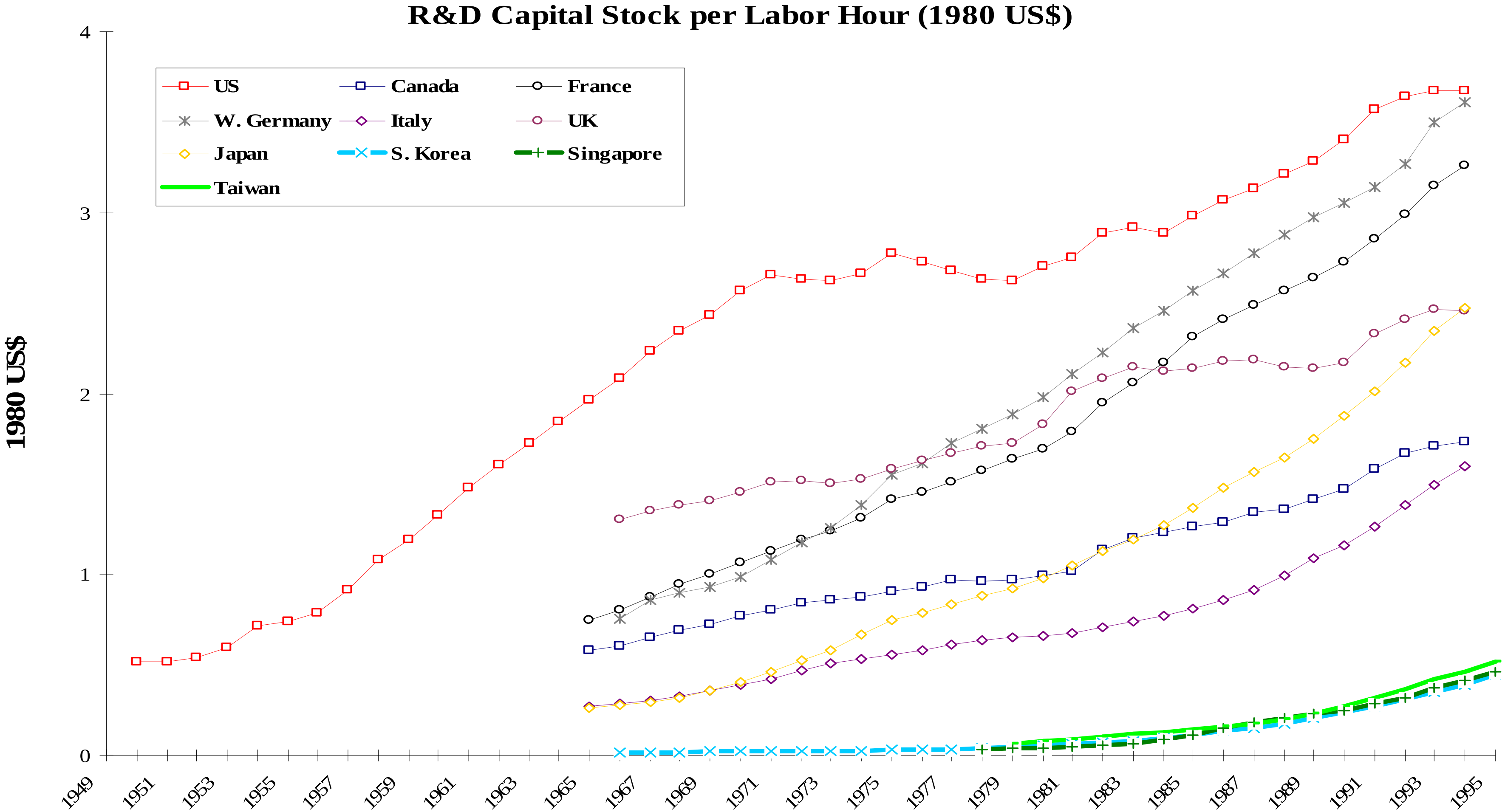


R&D Capital Stocks: G-7 Countries and 3 East Asian NIEs

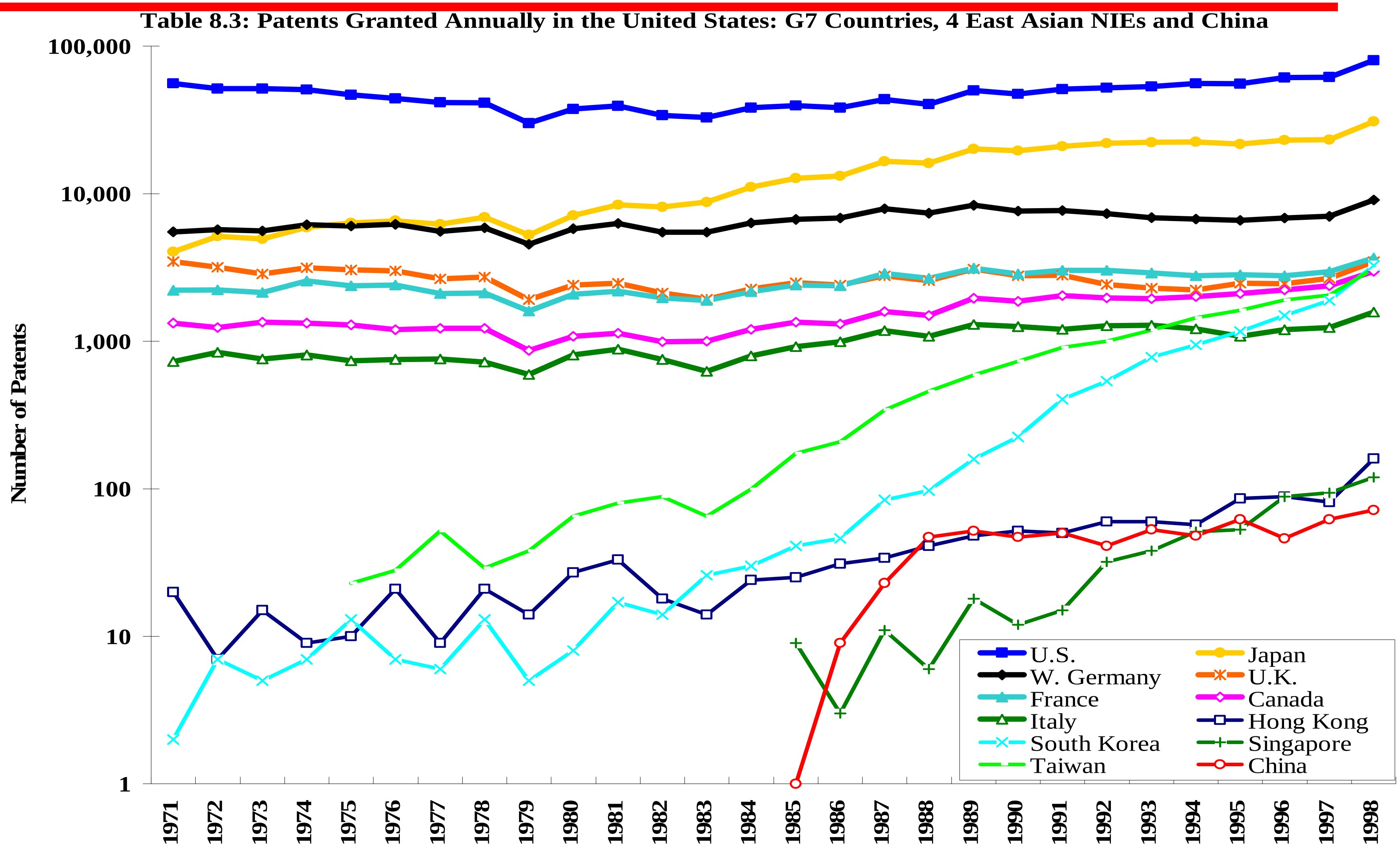
Figure 8.2: R&D Capital Stocks in Billions of 1980 U.S. Dollars



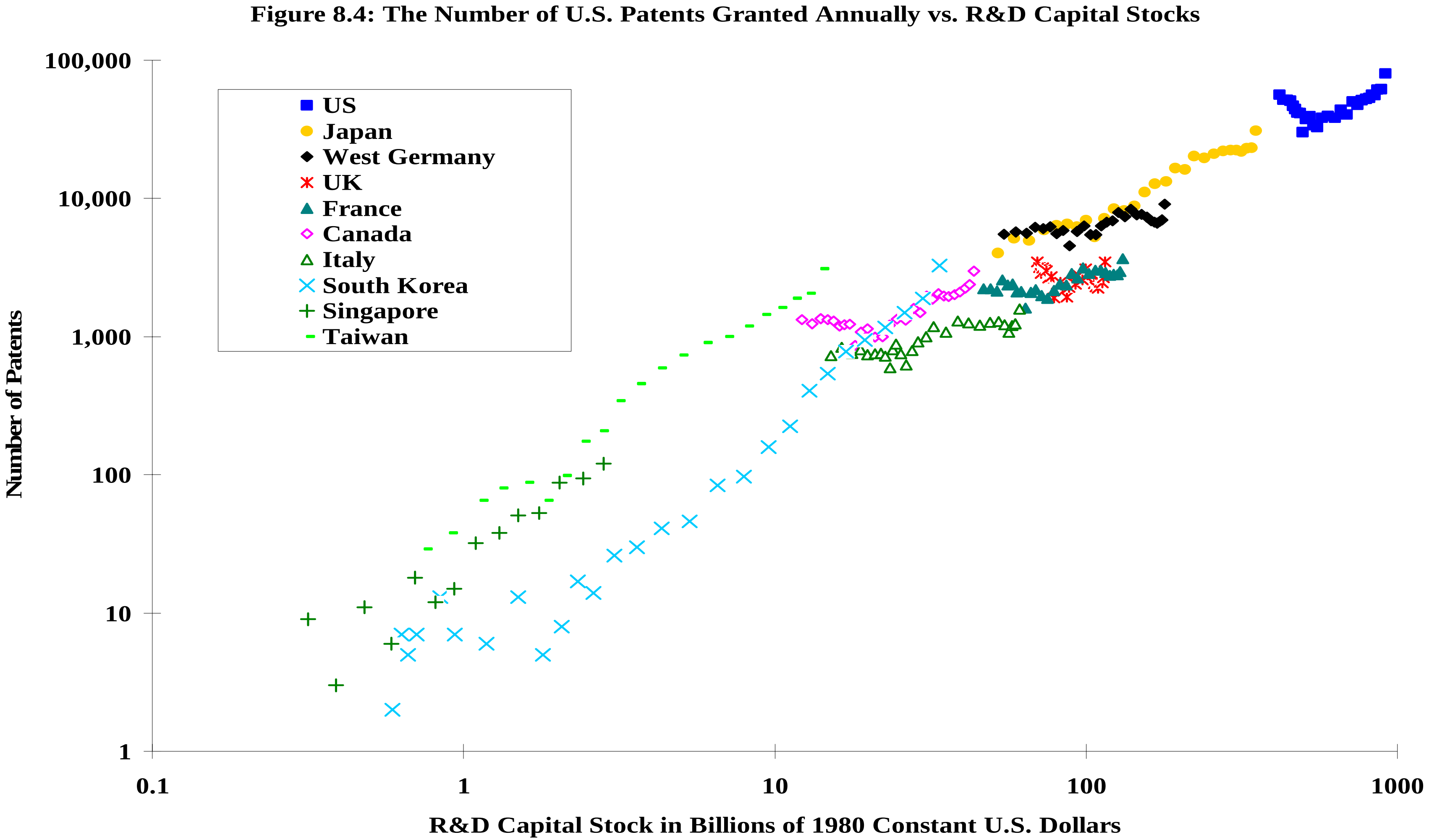
R&D Capital Stock per Unit Labor



Patents Granted in the United States: G-7 Countries and East Asian Developing Countries



Patents Granted in the United States and R&D Capital Stock



Prospects for Continued Rapid Economic Growth Remain Good

- Prospects for continued rapid economic growth in China remain good—huge room for tangible-inputs-driven growth because of its very low tangible capital per labor hour.
- Fundamentals are sound—high national savings rate, priority for education (and hence high rate of growth of human capital), market economy with rapidly expanding non-state ownership
- The experience of developed economies, especially that of Japan, suggests that investment in R&D capital and other forms of intangible capital has high returns once a certain level of tangible capital per unit labor is reached.
- Because of its complementarity with tangible capital, investment in intangible capital can retard the decline in the marginal productivity of tangible capital and counteract the “Krugman effect”
- There is also evidence of positive technical progress in the more recent period in South Korea, Singapore and Taiwan, reflecting their increased investment in intangible capital.

Is Chinese Economic Growth Sustainable?

- The attractiveness of investment in intangible capital depends on the protection of intellectual property rights, which in turn depends on whether a country is a producer of intellectual property--some of the East Asian economies, e.g., Hong Kong, South Korea, Singapore and Taiwan are ahead of other East Asian economies with the possible exception of Japan on this score.
- The people of China (and East Asia in general) are entrepreneurial, hard-working, and thrifty--all they need is a good, market-friendly, predictable and stable environment.

Long-Term Economic Growth: Favorable Factors

- A relative abundance of natural resources
- A potentially huge domestic market (Economies of Scale, “Coordination Externalities,” and Network effects)
- An almost unlimited supply of surplus labor
- A high domestic saving rate of approximately 40%
- A cultural preference for education
- A predilection for entrepreneurship
- The advantage of backwardness—the possibility of leapfrogging
- The agricultural sector has been performing well in terms of production
- Existing and expected fiscal reforms should reduce structural government deficit

Long-Term Economic Growth: Three Paradigms of Chinese Economic Growth

- Domestic demand-driven growth--the domestic market paradigm a la the United States in the 19th century. China is a large continental economy--International trade will never be as important as other, smaller countries and China must rely on internal demand for further economic growth. Value-added from exports constitutes only 6 percent of Chinese GDP.
- The "wild-geese-flying pattern" metaphor of East Asian industrial migration over time can apply to Chinese provinces and regions
- Privatizing the economy without privatization--shrinking the state sector through the growth of the non-state sector in the absence of explicit privatization--the experience of Taiwan and South Korea
- What does it take?
  - Availability of infrastructure (transportation and communication, including the internet)
  - Continued marketization of the economy
  - Maintenance of a domestically open economy (the equivalent of the "interstate commerce" clause of the U.S. constitution)
  - Affirmation of tangible and intangible property rights and the rule of law (a national commercial and tax court?)
  - Maintenance of an internationally open economy--the role of the "open door" (WTO)

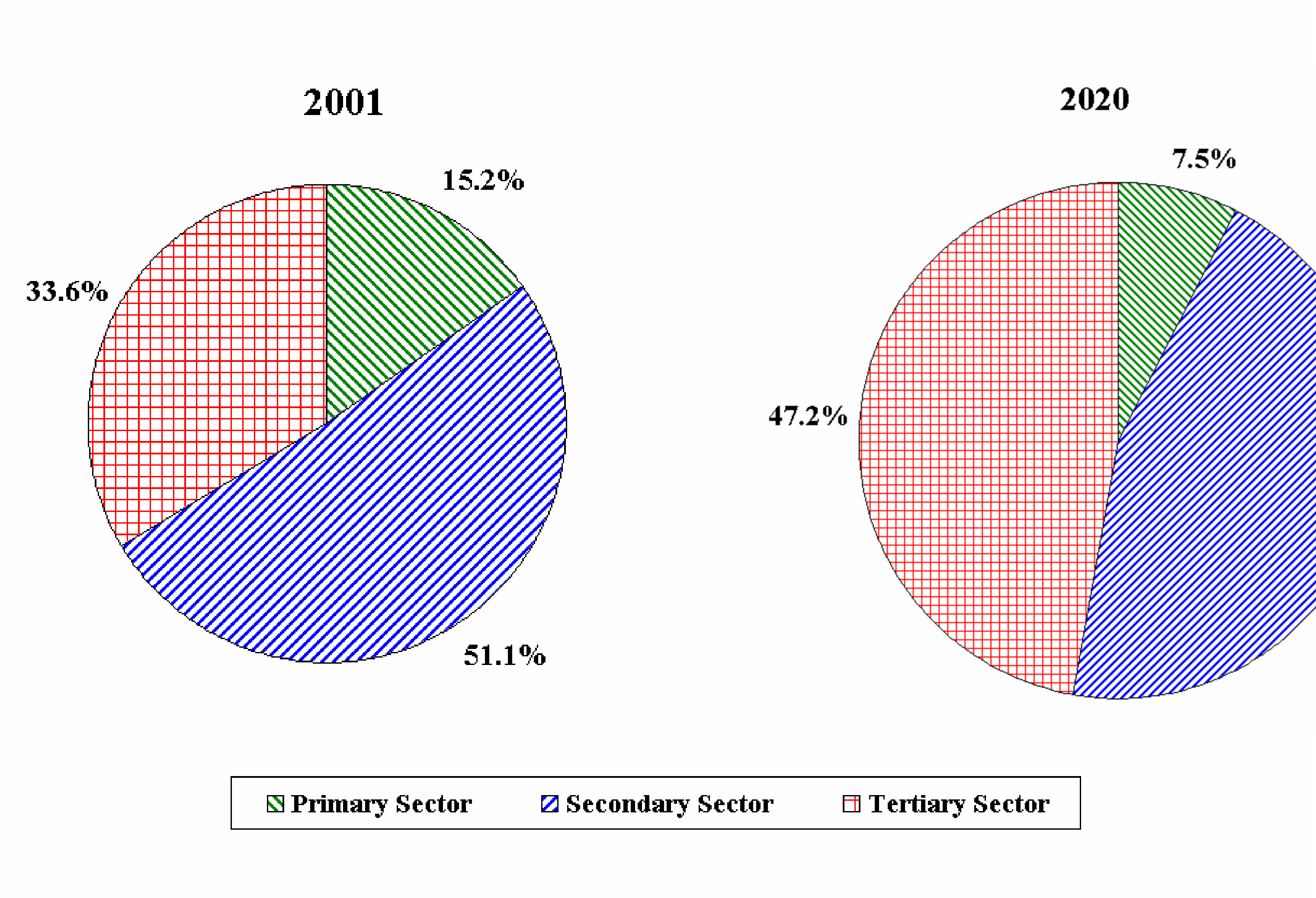
Long-Term Economic Trends

- Aggregate GDP
  - The Chinese economy is likely to continue to grow, more or less independently of what happens in the rest of the world, over the next several decades at an average annual rate of approximately 7%
  - The source of this growth will come primarily from tangible capital accumulation, supported by a national savings rate of 40%, human capital accumulation, and economies of scale, and to a lesser extent on the growth of intangible capital (for example, R&D capital) and improvements in efficiency
  - By 2020, aggregate Chinese GDP will exceed the aggregate GDP of Japan (and approximately half of aggregate U.S. GDP)
  - By 2035, aggregate Chinese GDP will reach the same level as aggregate U.S. GDP
- Per capita GDP
  - However, Chinese GDP per capita will only reach US$10,000, or approximately 20% of U.S. GDP per capita, in 2035
  - Chinese GDP per capita will approach the level of U.S. GDP per capita only beyond 2050
- Population
  - By 2035, India will have overtaken China as the most populous nation in the world
- The currency
  - The Renminbi will in time become one of the strongest currency in East Asia and a quasi-reserve currency like the Euro

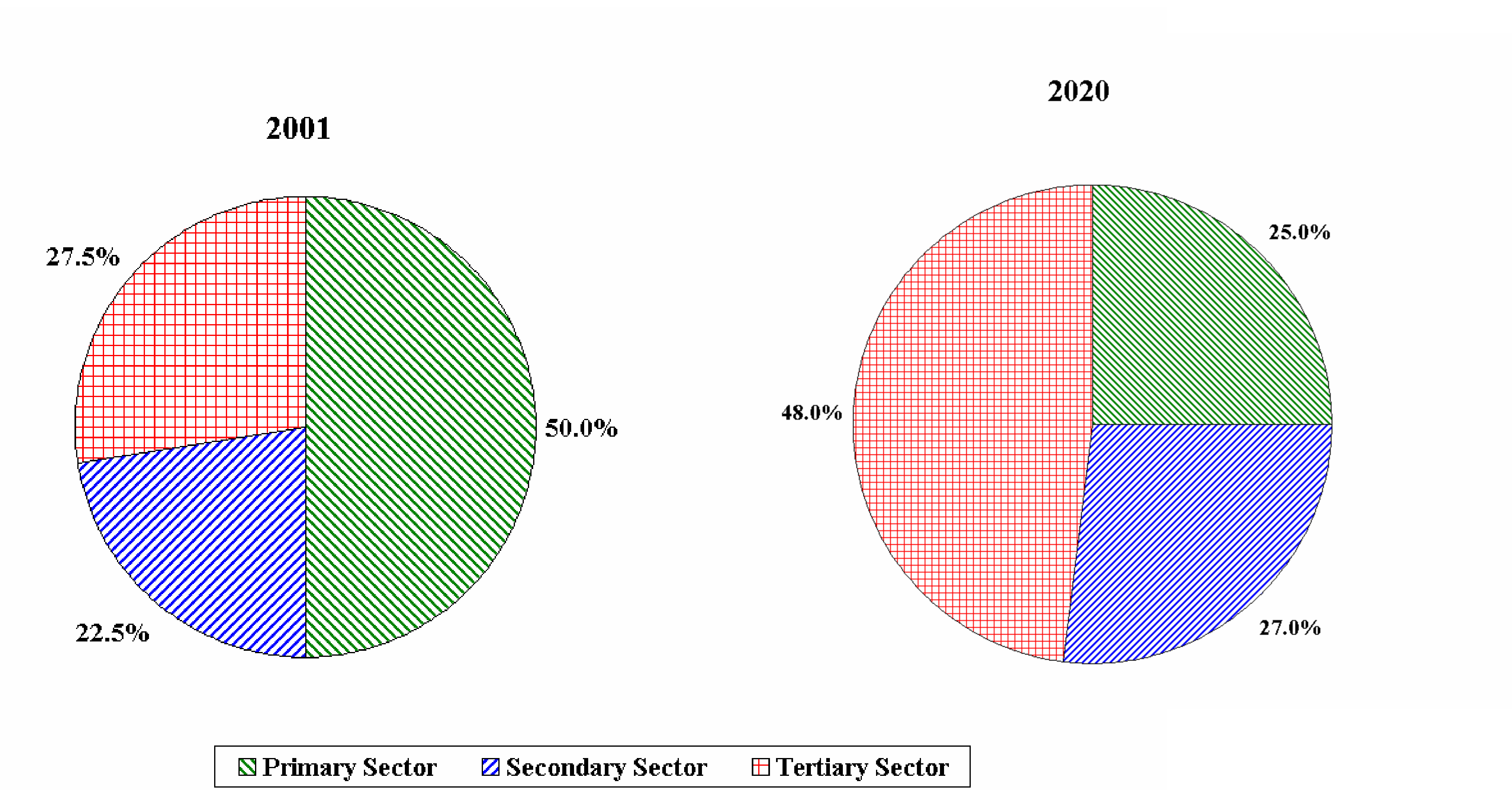
Long-Term Projections

	2002	2010	2020
	US$ (2002 prices)		
Real GDP	1.25 trilll.	2.25 trill.	4.5 trillion
Real GDP per capita	980	1,750	3,400

The Structure of the Economy: GDP



The Structure of the Economy: Employment



Prospects for Economic Growth

- Chinese economic growth during the next several decades will depend mostly on internal factors and be largely unaffected by the policies of other countries or events outside of China (a disruption of the oil supply may be an exception).
- There are numerous serious problems confronting the Chinese economy—however, these problems are not intractable.
- On the margin, foreign involvement in the Chinese economy will make some, but not a critical, difference; but it can be mutually beneficial for both China and the foreign countries.
- Chinese GDP and GDP per capita will remain low relative to the industrialized economies (G-7) for at least three or more decades.
- The share of Chinese GDP produced by the non-state-owned sector will rise from 65% to 80% in another decade.
- There is significant complementarity between the Chinese and G-7 economies--the G-7 economies do not export anything that China exports (and have not done so for decades) and China does not export anything that the G-7 exports. It is this complementarity that maximizes the potential gains from free trade between the two sides.

Sources of Growth of Aggregate Demand: Affordable Owner-Occupied Housing

- Huge pent-up demand for new affordable owner-occupied residential housing and rebuilt and renovated residential housing—a housing boom that can last for decades
- Promotion of affordable owner-occupied residential housing investment for and by the domestic population is one of the few alternative new and durable sources of growth of aggregate demand
  - Simultaneous adjustment of salaries and rents, providing purchasing power for employees not currently provided housing
  - Establishment of properties (transfer) rights to residential housing similar to those already available in the rural areas
  - Provision of long-term, preferably fixed rate, mortgages; development of secondary markets for such mortgages to avoid maturity mis-match; adoption of “safe-harbor” rules to over come “reluctance to lend”
  - Institution of urban zoning and land use laws; absorption of land costs but maintaining fairness through land leases adjustable upon renewal
  - Development of mass urban transit
- Housing reform has taken root in major urban centers except Beijing

Sources of Growth of Aggregate Demand: Affordable Individual and Mass Transportation

- Huge pent-up demand for new affordable automobiles—annual domestic demand now estimated to be in access of 2 million units
- In 2002/M9, automobile production increased 35.1% YoY to 325,000 units driven almost entirely by domestic demand
- In 2002/M1-11, automobile sales reached 1.02 million units, exceeding the 1-million mark for the first time
- Huge need for mass transit in both old and new cities

Sources of Growth of Aggregate Demand: Promotion of Science and Education in China

- Investments in information technology
  - Leap-frogging traditional development in telecommunication (the experience of the wireless phone)
  - E-commerce among enterprises
  - New models of marketing, distribution and sales
  - A PC in every classroom (in every urban home)
  - Set-top boxes on television sets with point and click device and numeric pad can link 400 million households to the internet
  - New modes of education and information dissemination
  - The Chinese language is uniquely suited to communication based on a graphic interface (the experience of the fax machine)
- Extension of compulsory education to 12 years
- Investments in tertiary education and in R&D

The Development of the Great West: Reducing Regional Inequalities

- Even though all regions benefited from the economic reform since 1979, the coastal regions benefited much more than the inland regions—there is an estimated 6 to 1 or even 8 to 1 ratio between the per capita GDP of the richest and poorest province/region.
- Interregional income inequality has risen, resulting in:
  - Dissatisfaction and restiveness
  - Deterioration of social services, especially education and health care
  - Massive illegal migration from the inland regions to the coastal regions, creating huge pressure on social and physical infrastructure
- Relaxation of rural-urban migration (mostly controlled by the local authorities)
- Transfer payments from the central government
- Raising agricultural incomes

The Development of the Great West: Reducing Regional Inequalities

- Moving jobs to where people are, not people to where jobs are
- Urbanization through the creation of new towns and cities, not the growth of existing towns and cities
- Developing a truly unified national market
- Education and investment in human capital is the most effective means for reducing income inequality
- Maintaining long-term competitiveness without devaluation; WTO accession can help by putting pressure on enterprises to move inland to lower their costs and maintain competitiveness
- Opening a new "Silk Road"—a direct land bridge to Europe and the relocation of the capital from Beijing to a city in the Western region of China can significantly accelerate the development of the Great West

The New Economy and China: The Advantages of Backwardness and Size

- The possibility of leap-frogging--there are no vested interests to protect; no existing businesses to be cannibalized; there can be “creation without destruction”
  - e.g., facsimile machines instead of telexes; video compact discs instead of VCRs; a new keyboard layout; mobile and wireless telephones instead of fixed lines; debit and credit cards instead of checks
- The possibility of influencing/setting standards--the markets are potentially large enough in China for the benefits of economies of scale to be realized and for it to have a significant influence on future standards
  - e.g., Linux; wireless telephone standards (CDMA)
- The possibility of local adaptation--taking advantage of local conditions
  - e.g., the Legend story—language; local supply and demand conditions, e.g., stability of the voltage of the electric power supply
- Transformation of the “Old Economy” through the information and communication technology

The New Economy Levels the Playing Field between Large and Small Firms

- Small firms can have access to services and supplies heretofore only available to large firms
  - E.g., by bringing down the cost of securities trading, Charles Schwab and E-trade benefit small investors proportionally much more than large investors
  - Rapid delivery services and warehousing facilities, e.g., Federal Express, are available to both large and small firms
- Small firms can also become more accessible to their customers and potential customers through the Internet with only marginal expenditures on advertising and public relations
- Small firms have access to large firms as potential suppliers in a global supply chain
- The Chinese economy with its high and potentially even higher concentration of smaller firms and more primitive information infrastructure (and thus the potential for leap-frogging) may benefit much more from the new economy than other more developed economies
  - E.g., B2B dot.coms seem to have relatively greater success in East Asia than in the United States