



# Avoiding the Blind Alley

China's Economic Overhaul and its Global Implications

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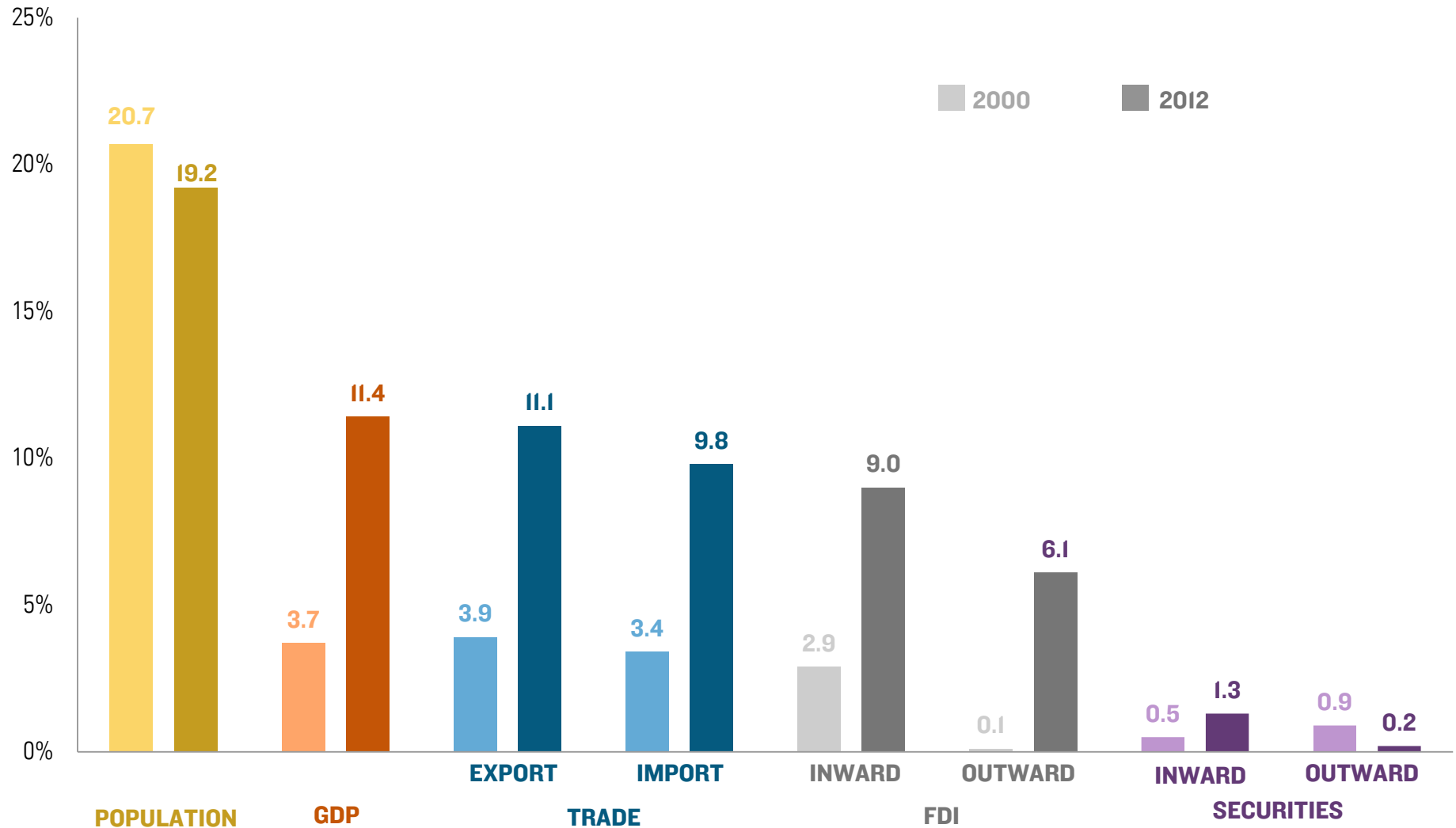
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# China in the Global Economy: 2000 vs. 2012\*

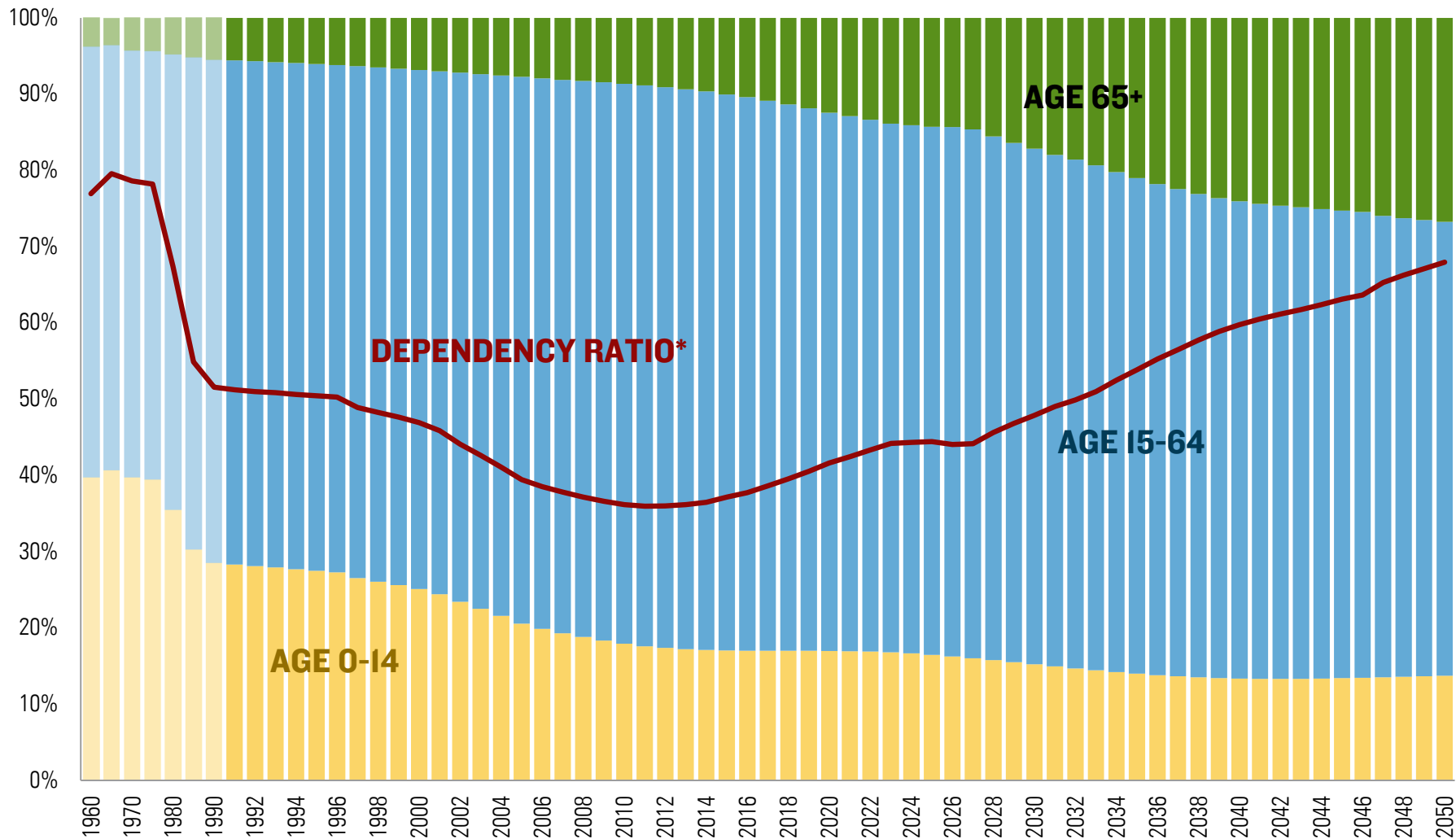
China's % share of global total



Sources: PBOC, UNCTAD, IMF, UNWTO, RHG. \*Latest available data used when 2012 is unavailable.

# Diminishing Demographic Growth

Population by age group, % of total

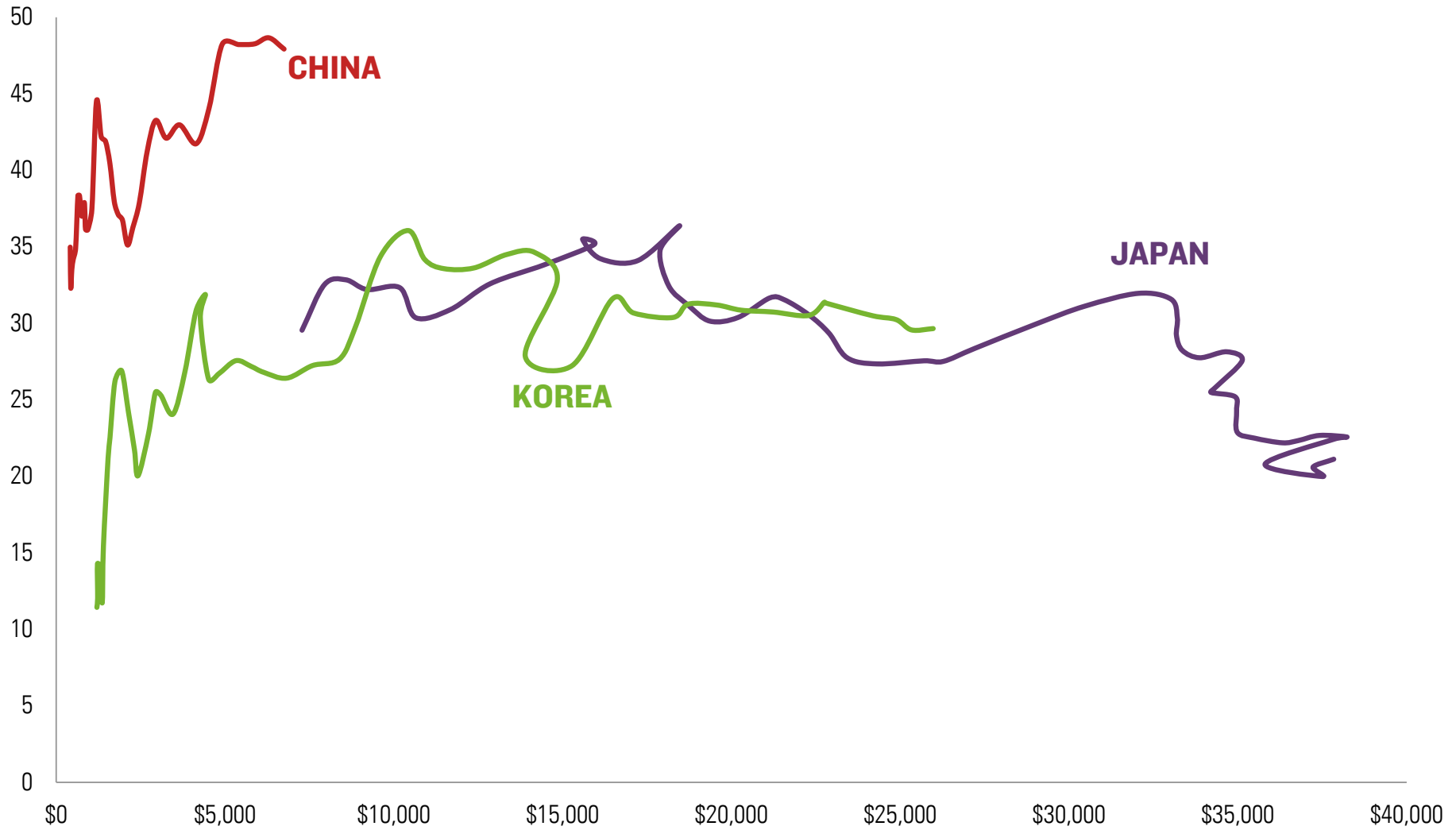


\* Ratio of people younger than 15 and older than 64 to working-age population (15–64).

Sources: China Statistical Yearbook, U.S. Census International Database (1990–2050).

# Diminishing Investment Growth: Capital at the Turning Point

Investment as % share of GDP v. per capita income (constant 2013 \$US)\*

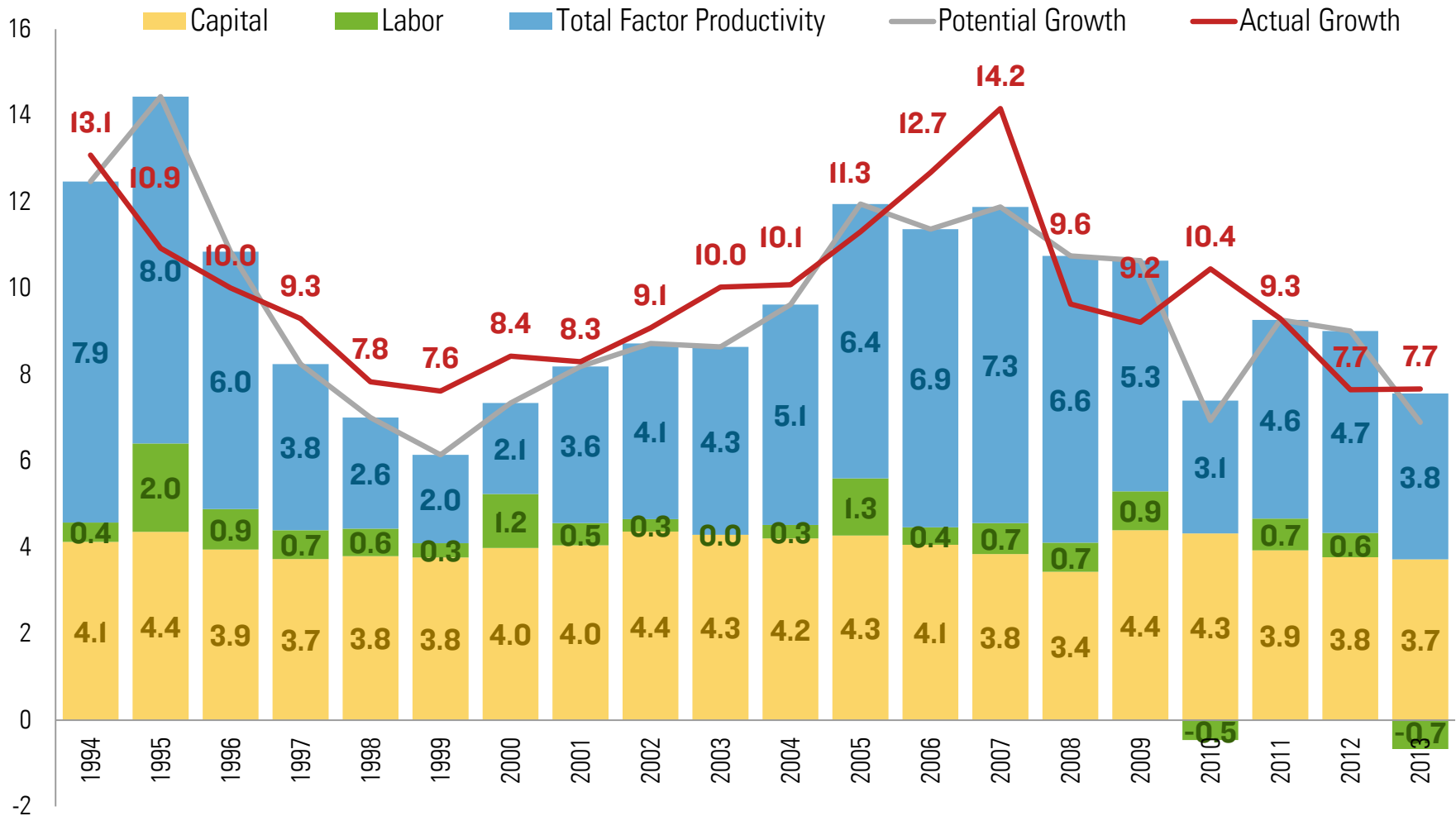


\* Investment is equal to gross capital formation, or new investment on assets plus net changes in stocks of goods held by firms.

Sources: Chinese National Bureau of Statistics, World Bank World Development Indicators, IMF World Economic Outlook (WEO) database, Rhodium Group estimates.

# Diminishing Total Factor Productivity: Reform is the Key

Components of potential growth and actual growth (annual %)\*

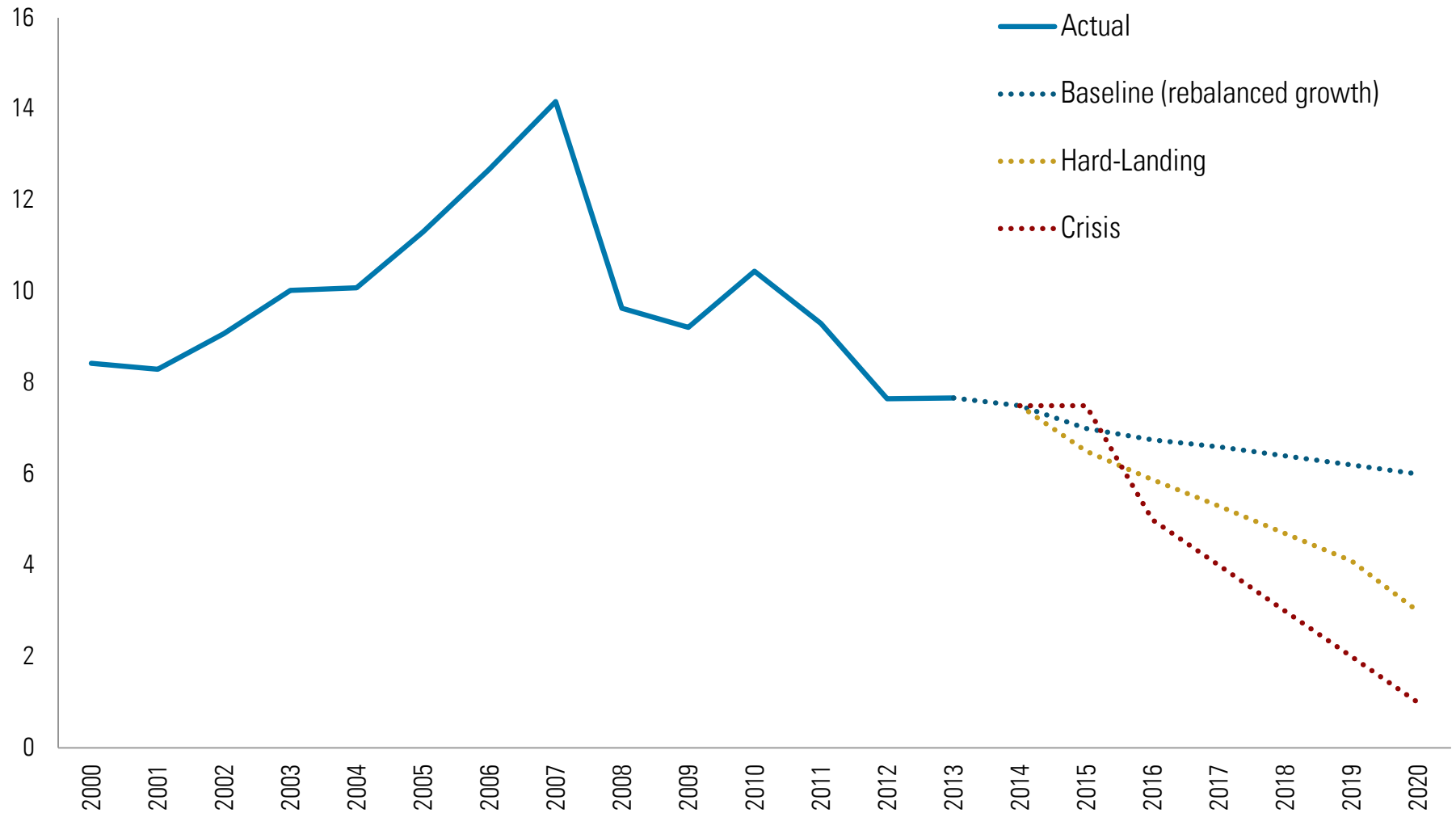


\* Potential growth is the maximum growth rate an economy can achieve without accelerating inflation. Potential growth is a function of the available capital stock, labor force, and total factor productivity (residual output from technological upgrading and structural adjustment that enhances the productive capacity of capital and labor).

Source: IMF 2014 Article IV Consultation, Chinese National Bureau of Statistics.

# China's GDP Outlook with and without Reform

GDP growth (% change year-on-year)



Sources: Chinese National Bureau of Statistics, Rhodium Group estimates. Projections begin after 2013.

# A Revised Mission for Government

- Maintain macroeconomic stability
- Strengthen and improve public services
- Safeguard fair competition
- Strengthen oversight of the market
- Maintain market order
- Promote sustainable development
- Promote common prosperity
- Intervene in situation where market failure occurs

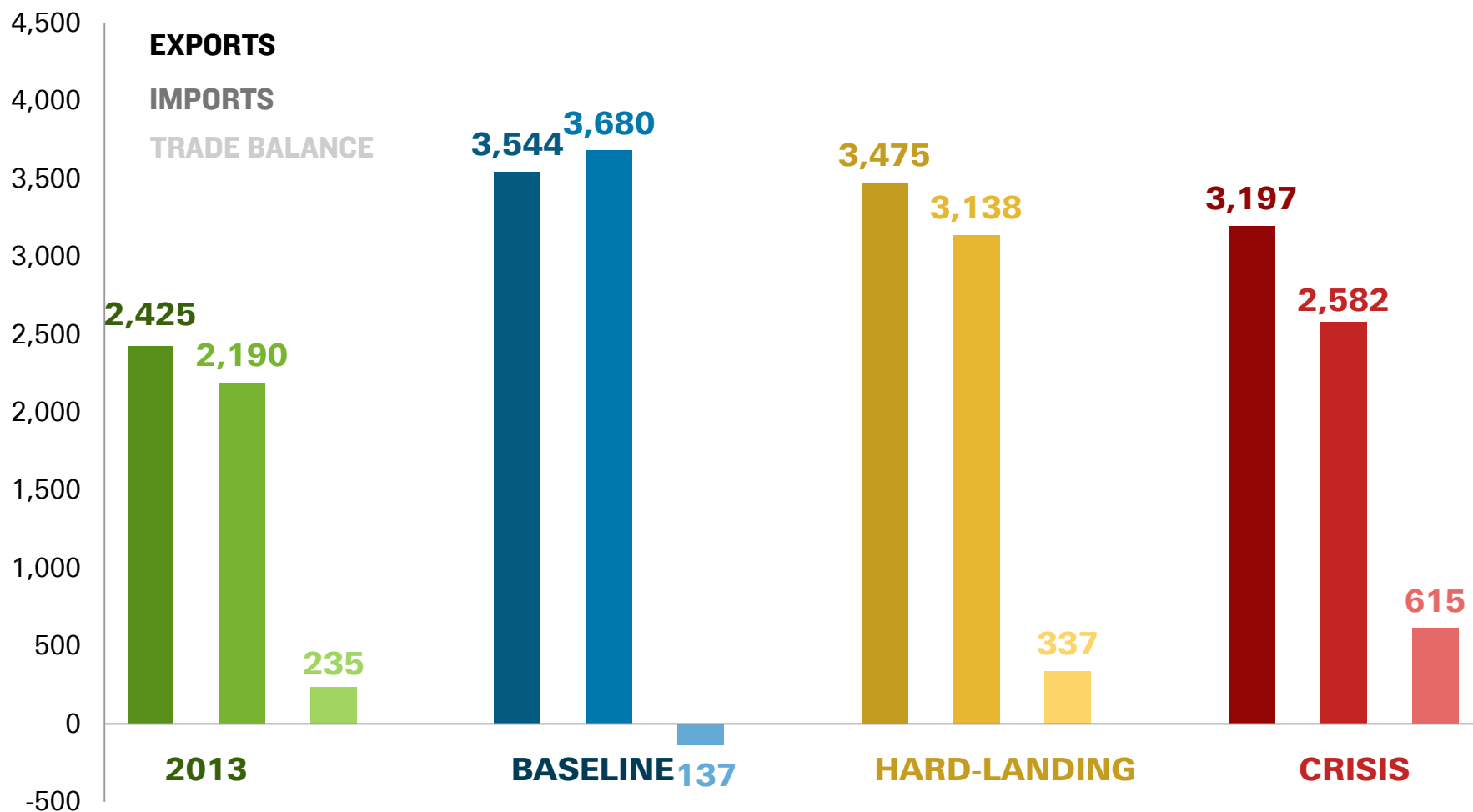
# Key Regulatory Objectives

Cluster	Center-Local Fiscal	Competition Policy	Financial System	Trade and Investment	State Enterprises	Land	Labor & Welfare	Environment	Innovation
Design	Major systemic re-alignment of responsibilities	Clear embrace of uniform elevation of competition as default mode with defined negative list, SOE coverage	Near-comprehensive coverage of internationally recognized reform agenda	Trade opening and the same laws and regulations for Chinese and foreign investment	Withdrawal from state control in competitive sectors; negative list; regulatory neutrality; competitive access to resources	Enforcement of land tenant rights; full registration of over 1 billion plots; due process in expropriations; partial end of <i>hukou</i> system	Education equality; employment/job creation priority; public expenditure reform; One Child Policy abolition	Cross-cutting imperative; quality of growth above quantity; emissions registration; utilize market mechanisms	Encourage market mechanisms in innovation; publicly funded research publicly available; education reform
Indication (examples)	June Overall Plan for fiscal and tax	Initial steps to remove anti-competitive authorities, upgrade enforcement, but uneven, and negative list still to come	Strong ongoing adjustment of financial price systems, partial new steps on capital markets, regulation, market entry (domestic), and financial account opening	Piecemeal trade opening but modest liberalization; good OFDI movement, modest and piecemeal FDI opening; piecemeal portfolio opening	Dividend reform; restructuring preparations; modest private investment; audits and management changes; rising private credit formation and market entry	Promising launch to registration campaign; audit of all 2008-2013 land takings; approval for 100 million urban <i>hukous</i>	Notable new business employment gains; public expenditure reform signs; OCP reform; minor education /health change but fiscal reforms are supportive	Amend EPL to permit public interest lawsuits; enhanced energy/coal policy constraint; emissions transparency	Modest incremental steps on IPR protection; steps on education reforms; action on public research availability
Outcomes (examples)	Unfunded mandates; property tax	Negative list coverage; due process	Interest rate liberalization, financial account opening	Trade balance; negotiation completion; negative list promulgation; 2-way FDI balance	Negative list terms; change in controlled sectors and firms; foreign restructuring of SOE JVs	Titling progress; <i>hukou</i> assignment; rural land prices	Increase rural education/health spending; labor & welfare data improvement	AQI improvement; NGO litigation; heavy industry market exit	Government directed/private R&D spend; 2-way IPR financial flows; indices of local innovation



# China's Trade Profile in 2020 under Baseline, Hard-Landing, and Crisis Scenarios

Constant 2013 \$US (billions)

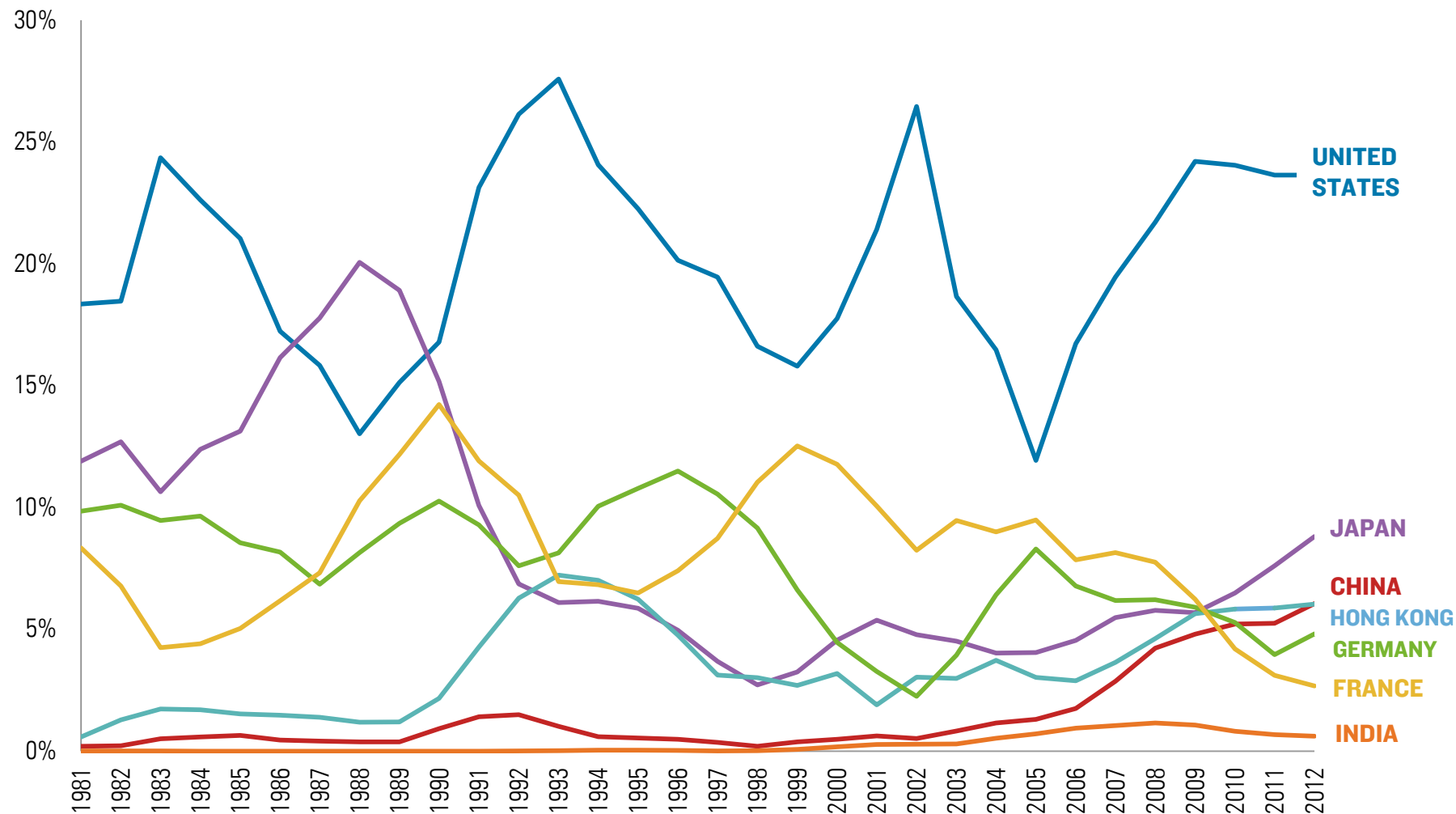


## Financial System: Decision 12

- Private market entry into banking (small and medium)
- Repair equity markets and convert to registration-based issuance
- Deepen market-oriented bond markets
- Rationalization of the insurance sector
- Market-determined exchange rates
- Move to market-based interest rates
- Marketize the government debt sector
- Open financial account for two-way capital market flows, with RMB convertibility for those transactions
- Redefining financial system regulatory functions to facilitate marketization
- Introducing deposit insurance
- Facilitate financial institution market exit (avoid “too big to fail”)

# China's Ascent to the World's Third Largest FDI Exporter

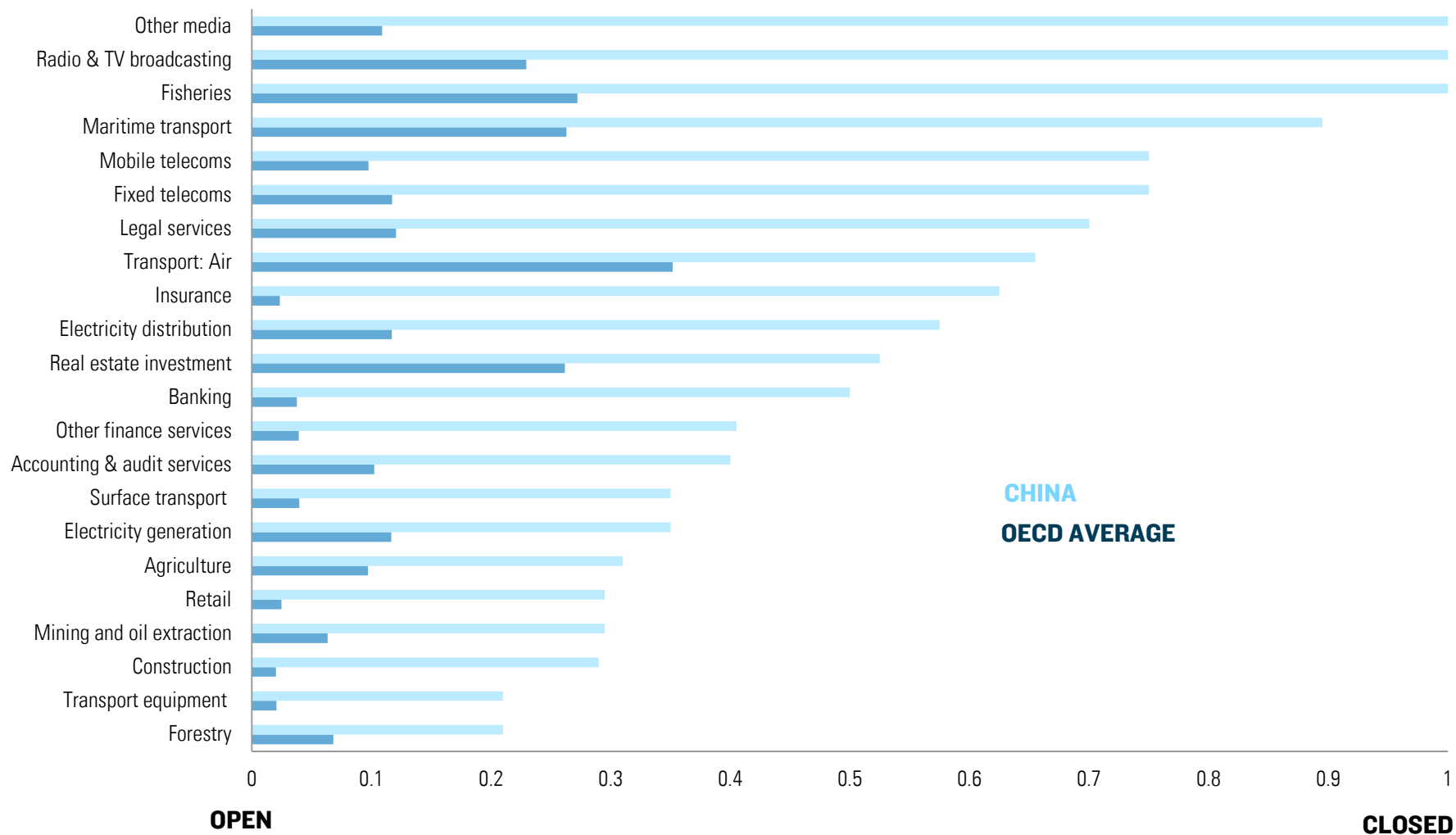
Countries' % share of total global OFDI flows, 3 year moving average



Source: UNCTAD, Rhodium Group.

# Concerns: Economic Considerations

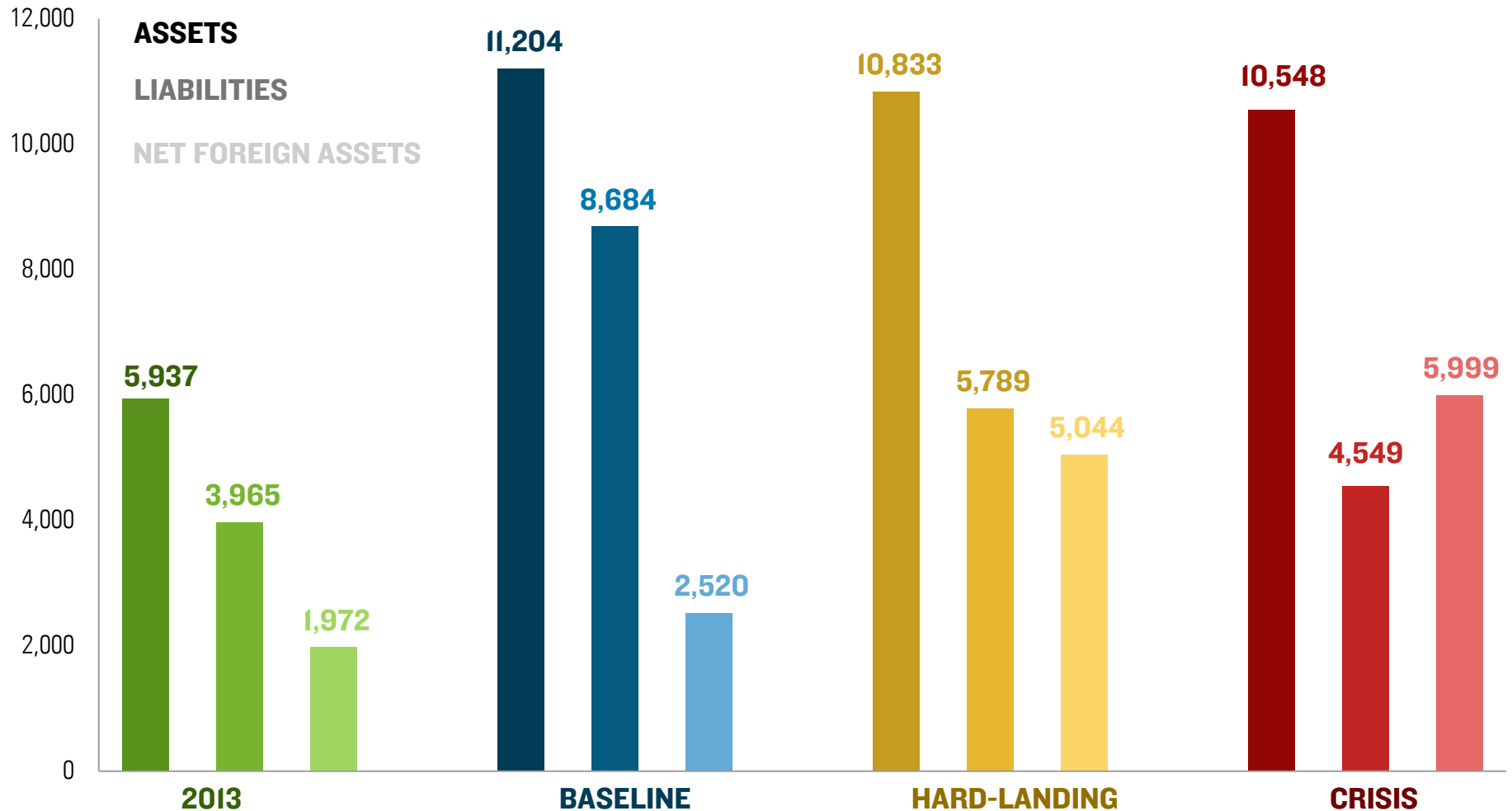
FDI Restrictiveness Index, China vs. OECD, 1=closed, 0=open



Source: OECD.

# China's Global Assets and Liabilities in 2020 under Baseline, Hard-Landing, and Crisis Scenarios

Constant 2013 \$US (billions)



Sources: People's Bank of China, State Administration of Foreign Exchange, Rhodium Group.

# Avoiding the Blind Alley

## Conclusions:

1. A Game-Changing Reform Program
2. A Convergent Economic Picture – with Idiosyncrasies
3. Plenty of Exceptions and Counter-indications
4. A Notably Fast Start, and a Move to Transparency
5. A Real Prospect for Political Adjustment?

## Recommendations

1. Gauge Incremental Progress
2. Demonstrate Support for Reform
3. Focus on a Domestic Response
4. Include a Multilateral Element
5. Stop Negotiating for What Beijing Is Already Doing