Discussion

1. Xingdong Chen

First of all, thank you to the RBA for their kind invitation. It is my great honour to comment on Guonan Ma, Ivan Roberts and Gerard Kelly's paper, 'A Rebalancing Chinese Economy: Challenges and International Implications'. It is a fascinating paper; a thorough examination and empirical study of China's economic growth and evolution over the past three decades. The findings of the paper, though the authors remind us that these are to be treated with caution, are, I believe, very valuable for both policymakers and businesspeople.

China is undertaking rebalancing

Economic imbalance or unbalanced growth has been a chronic problem in China. Talk of rebalancing growth can be found in government policy documents year after year, but little progress has been made. This is particularly true since the global financial crisis in 2008–09. Retaining high growth has overwhelmed structural reform and economic rebalancing in practice. And, at least so far, the old growth model can still generate the required output through policy stimuli.

While the authors discuss the internal imbalance between investment and consumption and the external imbalance between exports and domestic demand, it is worth noting that there are yet more unbalanced economic phenomena affecting China. Examples include regional development disparity, income disparity among the people and between urban and rural areas, and urbanisation lagging behind industrialisation.

I agree with the authors' observation that some rebalancing has actually started since 2012 but, by my observation, this round of rebalancing has been particularly forced rather than being the result of more organic and enduring changes. Even using the official growth estimation, GDP growth missed the targets for two consecutive years in 2014 and 2015.[1] Additionally, this growth was only achieved with extremely hard policy actions and, even then, the official growth estimations are widely doubted and believed to be overstated. Growth statistics are more inconsistent than before. These facts suggest that the old growth model is no longer powerful. The government can no longer command growth to meet its target. In fact, growth is seriously constrained by the structural imbalances.

Nonetheless, the new Chinese leaders, who came to power in November 2012, have recently become more serious about implementing policies to rebalance the Chinese economy. After spending more than three years on political power consolidation and policy framework set-up, the new leaders formally launched their rebalancing commitment from 2016 by announcing policies to lower overcapacity, reduce housing inventory and facilitate financial deleveraging.

1 The official GDP growth was 7.3 per cent in 2014 and 6.9 per cent in 2015, while the growth targets were set at 7.5 per cent and 7 per cent, respectively.

Rebalancing cannot be rapid

Despite these recent policy announcements, I totally agree with the authors that it is hard to foresee a rapid rebalancing. The existing economic imbalances have developed through a long and complicated history. The imbalances can be attributed to both tradition and the catch-up development strategies in the past three decades. China's high household saving ratio is a result of poor development of the social security system, poor consumer financial credit availability, policies that are less favourable to consumption, and the Chinese saving and thrift culture.

Economic rebalancing through restructuring is a hard task. To close a 'zombie firm', for instance, would raise tough questions as to how to resolve the huge debts and associated unemployment caused by such a closure. Because of these non-performing loan risks and job security, the Chinese Government has set its growth target at an average of 6.5 per cent over the next five years and a range of 6.5–7.0 per cent for 2016. I believe the bottom line growth target is meant to pave the way for smooth structural reform, though it will be difficult to achieve.

Notwithstanding this, I also agree with the authors that rebalancing cannot be too slow. Otherwise, rebalancing progress may be left behind and new imbalances may occur. For example, being aware of the tough challenges, China's National Development and Reform Commission (NDRC) set a modest target to reduce annual steel production capacity by 100–150 million tonnes over the next five years. I do not think this will be enough; I believe China needs to reduce capacity by at least 300 million tonnes. It is estimated that China has aggregate annual production capacity of no less than 1.2 billion tonnes of steel. The aggregate demand in the domestic market, on average, in the next five years would not be more than 700 million tonnes per year. Provided an 85 per cent capacity utilisation ratio is sufficient for economic return, China needs no more than 900 million tonnes of steel production capacity.

I see China walking a tightrope trying to balance reform and growth as the new normal. Nonetheless, I am cautiously optimistic that China will gear up its restructuring and rebalancing going forward, while gaining confidence in the process. Next, I will discuss some of the forces that give me this confidence.

Consumption and the services industry are booming

According to official statistics, if making an international comparison, consumption in China has grown rather rapidly, although growth of investment has been stronger still. Consumption of services is surging. Tertiary output grew 8.3 per cent in real terms in 2015 and substantially outpaced secondary industry, which grew by 6 per cent. In 2015, the services industry made up more than half of China's GDP for the first time and accounted for 66 per cent of real growth. The strength in the services sector was apparent across a range of sub-sectors: wholesale, retail, transportation, communication, postal services, logistics, tourism, hotels, catering, banking, wealth management, insurance, real estate services, housekeeping, health care, retirement life, nursing homes, sports, entertainment, education and legal services.

While this strength is a reason for confidence, I have long wondered if the consumption statistics have understated growth. Many kinds of consumption have been miscounted. For example, most consumption associated with corruption and a lot of the consumption of the owners and family of private businesses are ascribed to intermediate spending on production and business operation. As a result of the government's anti-corruption campaign, the consumption associated with corruption has substantially reduced, if not vanished. Financial disciplines and tax enforcement would also help to reduce the consumption by owners and their families at the cost of their business operations. The correction of the distortion in the statistics would, of course, help to reduce the level of imbalance between consumption and investment. But most importantly, all the changes would help to boost real private or household consumption.

Furthermore, having recognised the obstacles holding back consumption in China, the government is now making massive efforts to reduce administrative hurdles, to promote consumption through changes in product mix, consumer financial credit, taxes and fees. What's more, the new generation is taking the lead in consumption spending. The saving and thrift culture is waning.

But investment remains the decisive factor in the short and medium term

While China is progressing its economic restructuring and rebalancing, the government appears to have retained growth as the policy priority. An average growth target of 6.5 per cent in the next five years has been chosen not only for realising its centennial objective to double GDP between 2010 and 2020, but to cushion the risks and challenges of rebalancing.

The modest failure to achieve the growth target in the past two years has not occurred because of consumption or exports, but because of investment. The NDRC set growth targets for fixed asset investment (FAI) of 17 per cent in 2014 and 15.3 per cent in 2015, but actual growth was only 15 per cent and 10 per cent, respectively. In Chen and Rong (2015) I estimate that, if China were to realise GDP growth of no less than 6.5 per cent this year, FAI growth should be no less than 8 per cent. But, from its leading indicator, the budgeted growth of the projects under construction is currently less than 5 per cent, far from being strong enough. Considering this, and in line with its growth targets, we should expect China to introduce more new investment projects in infrastructure, urbanisation, industrial renovation and technology over coming years.

Internal rebalancing to affect renminbi internationalisation

Turning from internal rebalancing towards external factors, one of the paper's findings is that, because of the higher import intensity of Chinese investment relative to consumption, rebalancing from investment to consumption could place pressure on the imported share of GDP. If China's exports as a share of GDP remain relatively stable, it would mean China's trade surplus would increase.

This would be an interesting development and I think it could have implications for the internationalisation of the renminbi (RMB). China is pushing the internationalisation of its currency and wants more RMB to be used internationally. Apart from increasing RMB loans, outward direct investment (ODI) or financial portfolio instruments, a trade deficit is an effective way of increasing the supply of overseas RMB. Thus, I wonder if the predicted increase in China's goods and trade surplus associated with internal rebalancing could slow RMB internationalisation?

International spillovers

Finally, I have a few comments on the international spillovers of Chinese rebalancing. Though it is rather depressing, the authors find that rebalancing in China would likely have more negative effects than positive on the countries that export resource commodities and capital goods.

Economic restructuring and growth rebalancing would likely have substantial negative effects on Australia, which has relied heavily on exporting resource commodities such as iron ore and coal, among others. Domestic coal prices have already plunged by 57 per cent from their peak in 2004 and coal imports decreased by 30 per cent in 2015. Growth of imported iron ore volumes was 2.2 per cent in 2015, compared with average growth of 16.8 per cent in 2003–15. It seems that the negative effects of China's rebalancing have just begun and could persist for the next 3–5 years.

However, China's internal restructuring and rebalancing would benefit the international market and Australia in other areas. As the paper sets out, China's potential demand for food, forestry & fishing products, tourism, education, health care, property and ODI are enormous. China's tourists travelling overseas amounted to 127.9 million individual trips in 2015, up from 57.4 million in 2010. This has occurred even though it is said that only 5–7 per cent of the Chinese population have passports. I am sure that numbers of Chinese overseas tourists will continue to surge. China's ODI reached US$118 billion in 2015, up from US$60.2 billion in 2010 and close to the amount of foreign direct investment in China (US$126.3 billion in 2015). China is also opening up its domestic capital market. The Panda bond market is developing and foreign company equity initial public offerings in China could be possible in the future.

Reference

Chen X and J Rong (2015), '2016 Perspectives: 10 Top Questions', BNP Paribas Economics Report: China Economics, 16 December.

2. General Discussion

Much of the discussion centred on the importance of investment efficiency in the relationship between rebalancing and growth, with higher efficiency permitting faster overall growth for a given degree of rebalancing. It was noted that, despite the rapid increase in China's capital-to-output ratio over recent years, the capital-to-labour ratio remains low in comparison to that of developed countries. Some participants suggested that the size of the capital stock in China is still too small for recent declines in the return to capital to be interpreted as diminishing marginal returns to the capital stock; instead, these lower returns should be viewed as a symptom of allocative inefficiency and shortcomings of the financial system.

One participant noted that the return on assets in the private sector is significantly higher than that in government-owned sectors. Given the size of assets under government ownership, this suggests that reforms aimed at increasing the competitiveness of the government-owned sector would be beneficial. The increase in return on assets would also allow higher rates of economic growth to accompany a decline in the investment share of output. The authors noted that although the capital-to-labour ratio remains very low, the capital-to-output ratio has recently come to approach that of developed countries and agreed that this suggests that there is significant room for improved investment efficiency. However, they expressed doubts that the return to capital would rise significantly given the likely reversal of the positive productivity and demand shocks that drove high returns to capital in recent decades.

One participant questioned the attribution of China's high investment and saving rates primarily to positive shocks rather than to factor market distortions caused by government policy. This argument appealed to standard neoclassical theory, under which a positive shock that raised permanent incomes would result in higher present consumption in the absence of credit constraints or risk aversion. The authors argued that the effect of various distortions on consumption, savings and investment are ambiguous and provide an inadequate explanation of how such rapid consumption growth in an emerging economy can be accompanied by even higher investment growth and a current account surplus. The authors posited that positive demand and productivity shocks were capable of boosting income even more than consumption.

On the topic of China's high overall saving rate, one participant emphasised the importance of corporate savings as well as household savings. Another participant questioned the sustainability of a high household saving rate in the future, given the declining working-age population in China. One participant remarked on the novel use of flow-of-funds data to attribute the large increase in China's saving rate principally to increasing gross capital formation undertaken by the household sector. The authors commented that a doubling in household gross capital formation as a share of GDP over a period of 20 years could be regarded as a decisive factor in China's unbalanced demand profile, considering the counterfactual in which this investment expenditure were instead allocated to consumption.

A participant argued that the imbalance between consumption and exports was more significant than the imbalance between consumption and investment, as it better signified the excesses of Chinese savings. It was argued that the current account surplus may be reversed in the future as the composition of Chinese production comes to more closely resemble the composition of Chinese demand, rather than being disproportionately geared towards the production of light manufactures requiring large export markets.

Several participants commented on the input-output based analysis of the consequences of Chinese rebalancing for China's trading partners. One expressed surprise at the difference between the effect of Chinese rebalancing on Australia and New Zealand, given the similarities between the two economies outside of mineral endowments. It was argued that the tourism and education industries would grow significantly in importance and that the overall effect of rebalancing on Chinese demand for imports may be positive.

Another participant questioned the results because the most recent global input-output tables are from 2011, when iron ore prices were at their historic peak. It was argued that with the recent declines in commodity prices, the import intensity of consumption may now be closer to that of investment than it was in 2011. It followed that the overall effect of future rebalancing on Australian exports might not be as negative as suggested by the paper. The authors acknowledged the limitations of global input-output data, given that they are released with a considerable lag and that coefficients relate to nominal values that do not distinguish prices from quantities. It was acknowledged that commodity price declines over recent years may have reduced the intensity of Chinese investment demand for Australian value added, but that the composition of Chinese consumption demand would still likely have to change considerably in order for an average unit of Chinese consumption to match an average unit of Chinese investment in terms of demand for Australian value added.