

Policies to Raise the Role of  
Consumption  
for IMF workshop on  
“Catalyzing Domestic Demand”  
Jan. 21, 2010

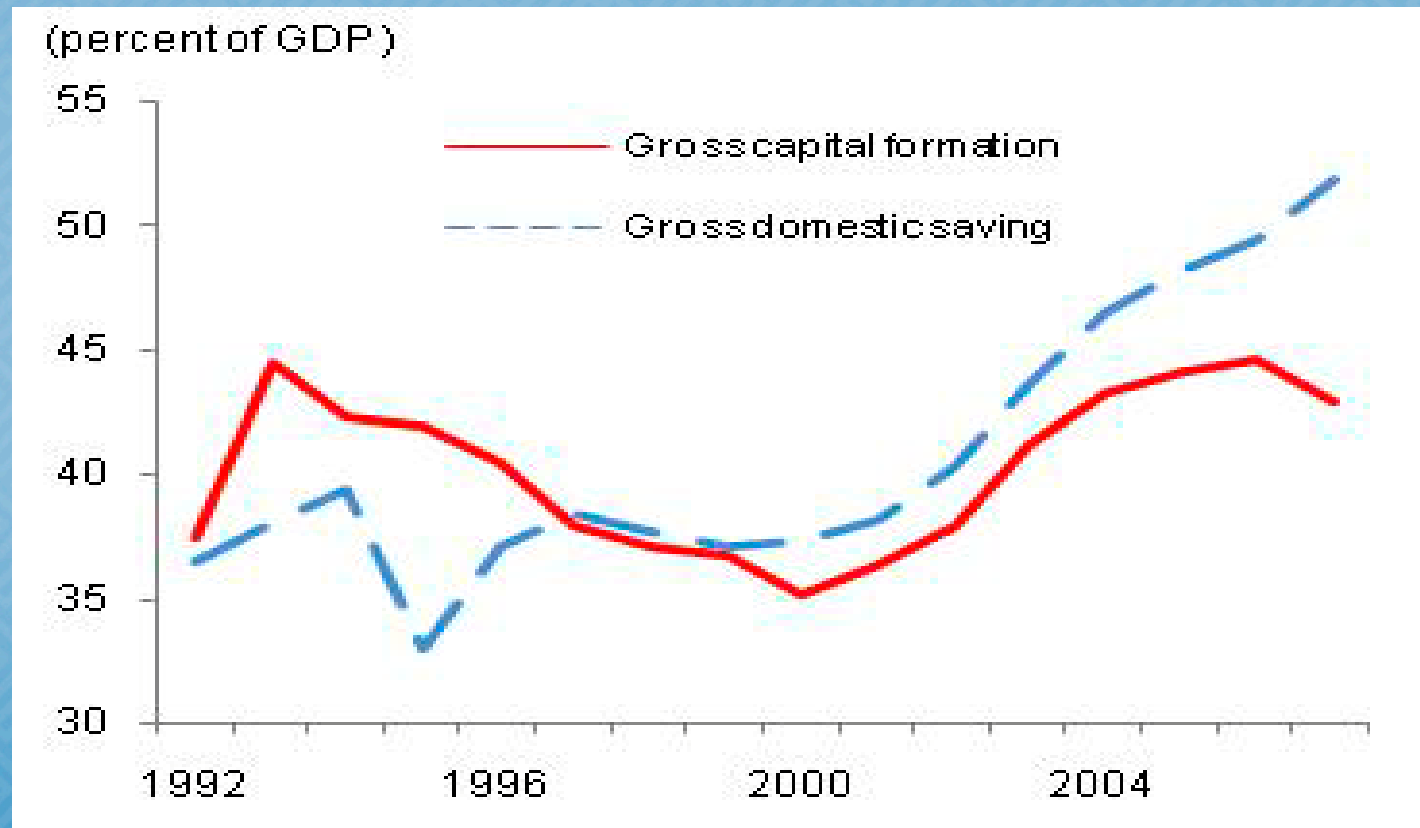
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# Outline

- China's pattern of growth; the case for rebalancing in order to raise the role of consumption
- International perspective: the experience of OECD countries and lessons from it
- Policies to rebalance China's pattern of growth and raise the role of consumption

- Key characteristics of China's traditional pattern of growth

# 1. Saving and investment are high



Source: CEIC, World Bank estimates

# A large and increasing part of saving is by enterprises and the government

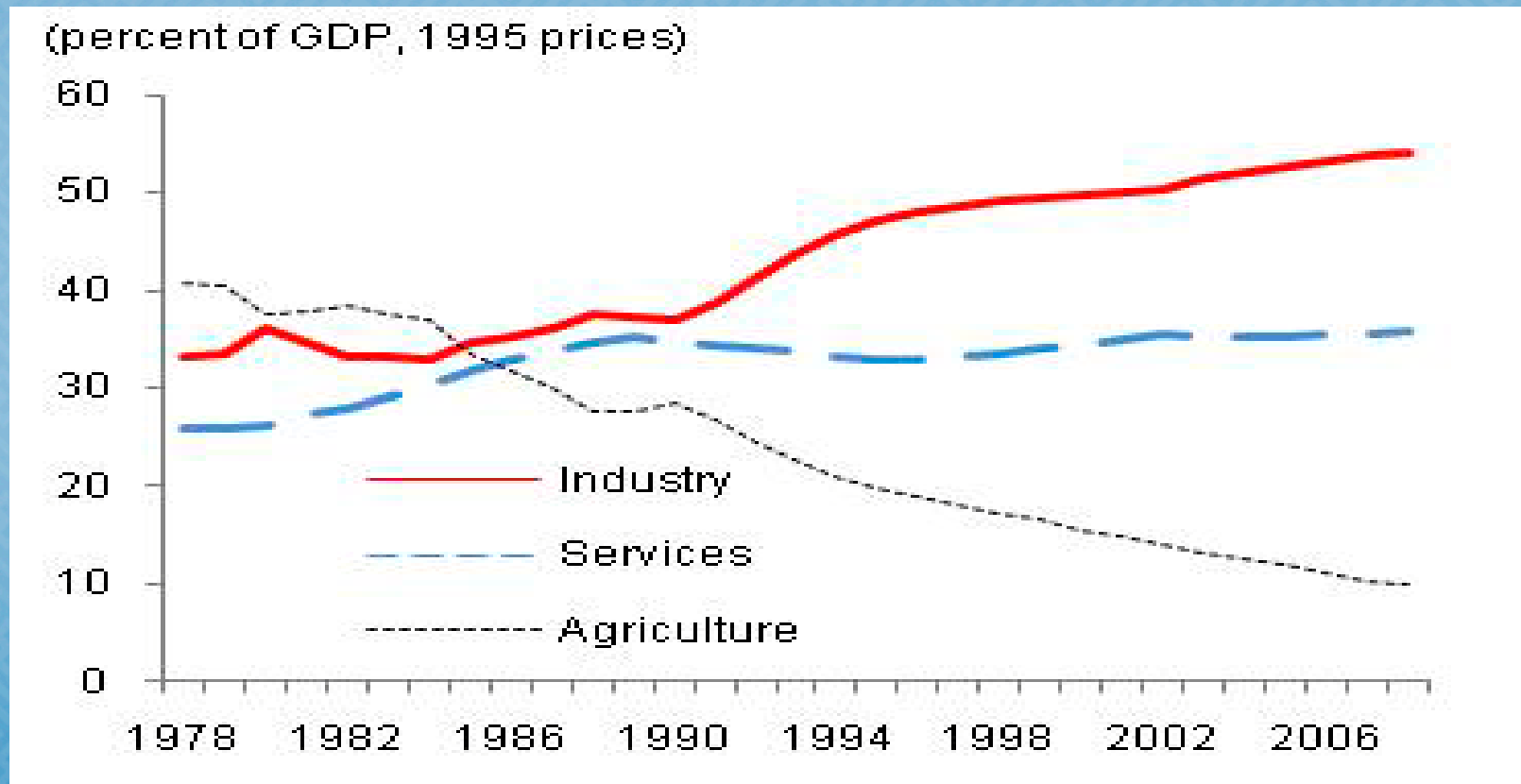
% of GDP

	1997	2007
Gross domestic saving 1/	38.4	51.8
Households	21.4	22.2
Enterprises	13.0	18.8
Government	4.0	10.8
Gross capital formation	37.9	42.8

Source: CEIC, World Bank estimates.

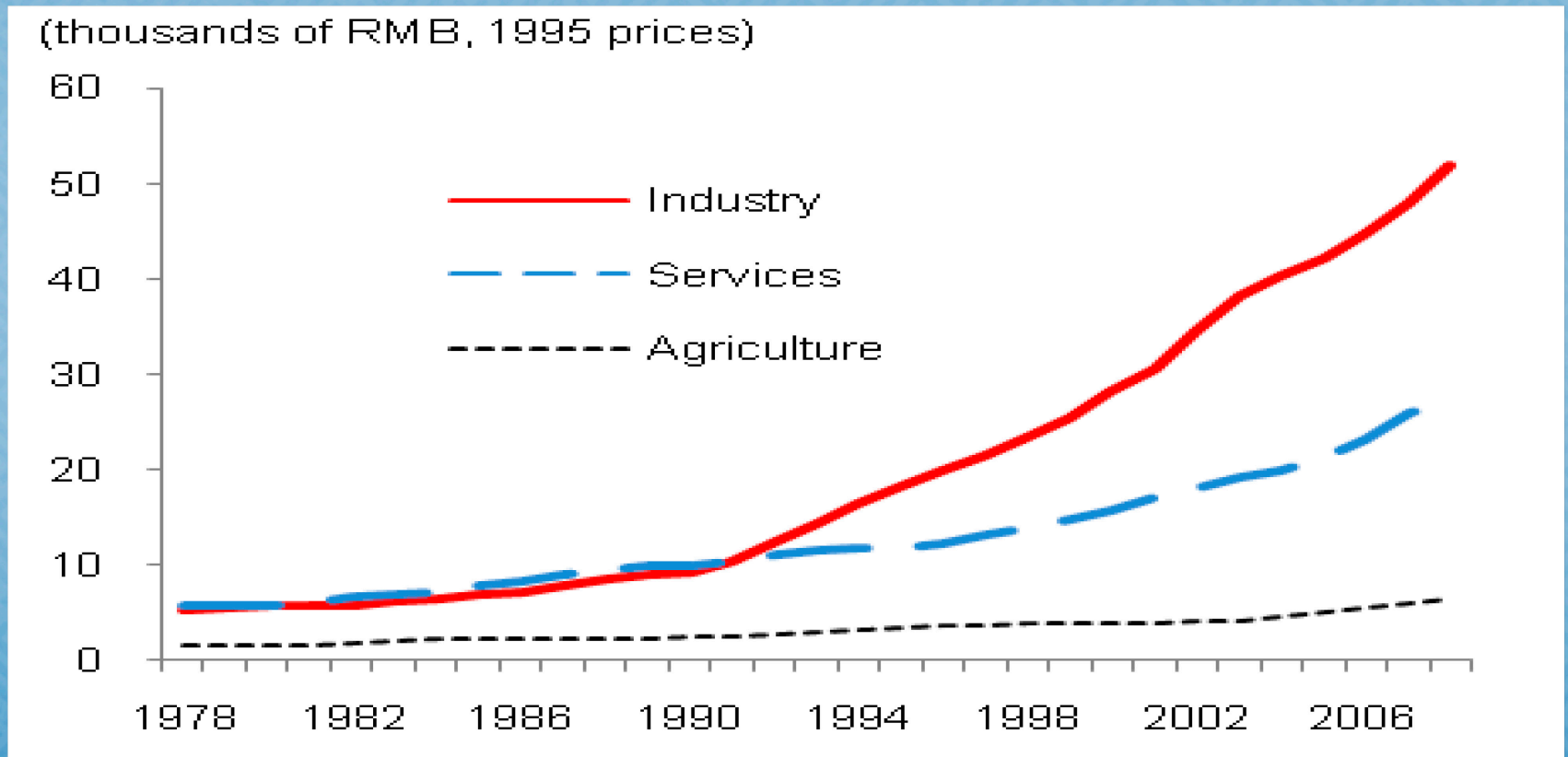
1/ Flow of funds data. Data from the household and industrial surveys suggest higher enterprise saving in 2005-07.

## 2. Growth has been led by industry



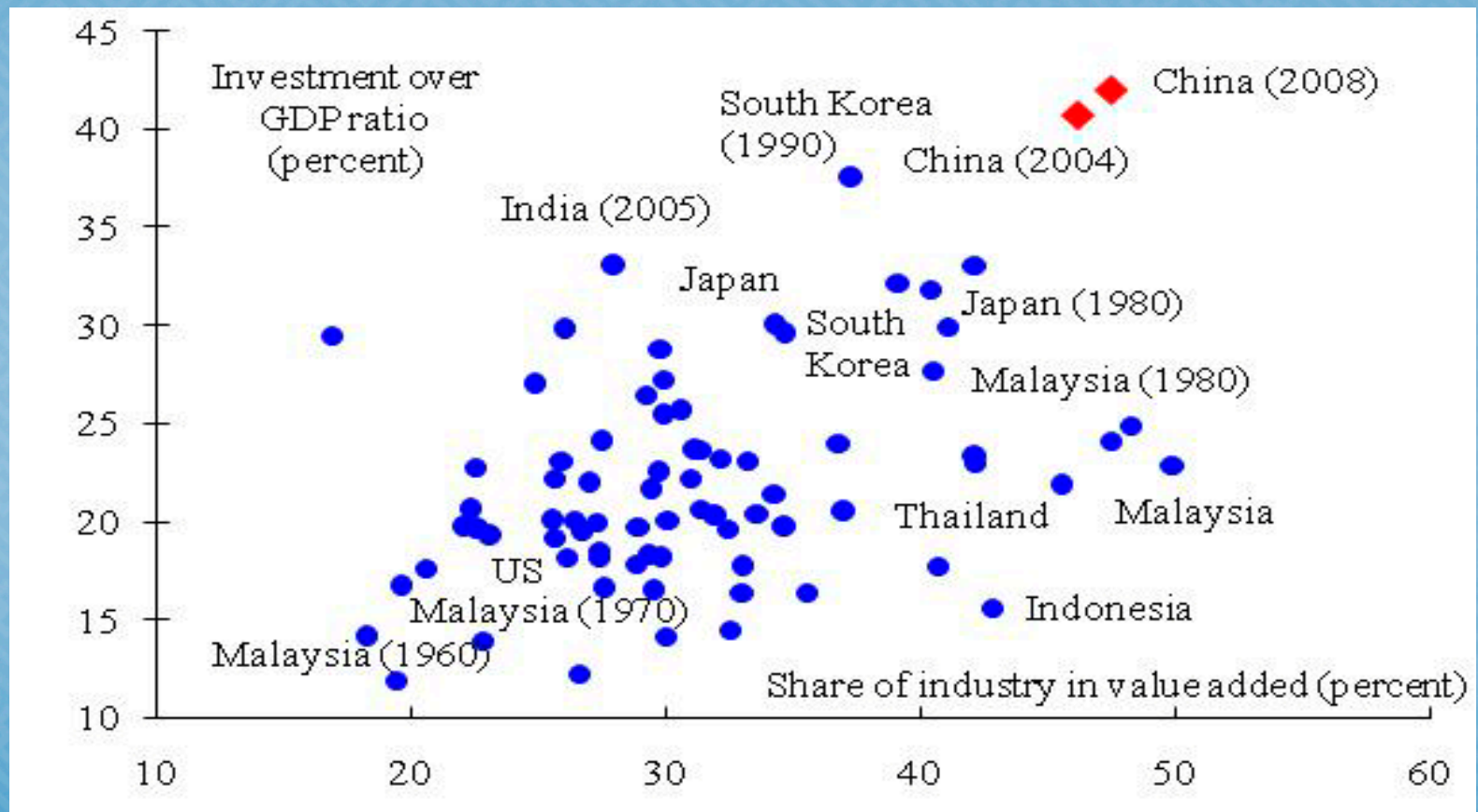
Source: CEIC, World Bank estimates

### 3. Industrial growth has been largely in the form of labor productivity growth



Source: CEIC, World Bank estimates

# High weights of investment and industry are related



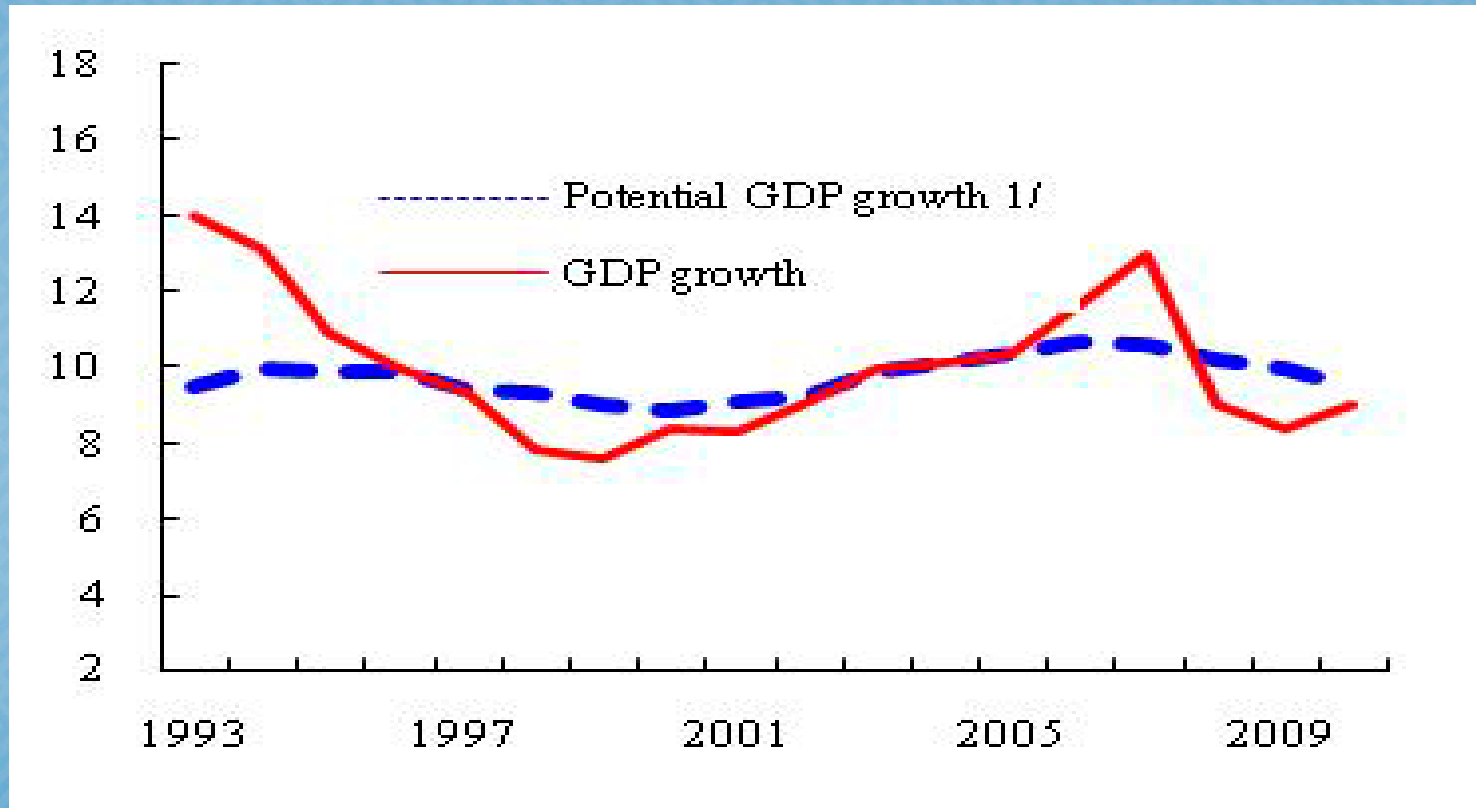
Source: CEIC, World Bank estimates



# Capital-intensive, industry-led growth is accentuated by policies

- Policies have encouraged S and I
- Investment in industry has been encouraged
- Service sector did not get much attention
- Permanent migration to cities has been contained

# This pattern has served China well



Source: CEIC, NBS, World Bank estimates.

1/ Based on Cobb Douglas production function.

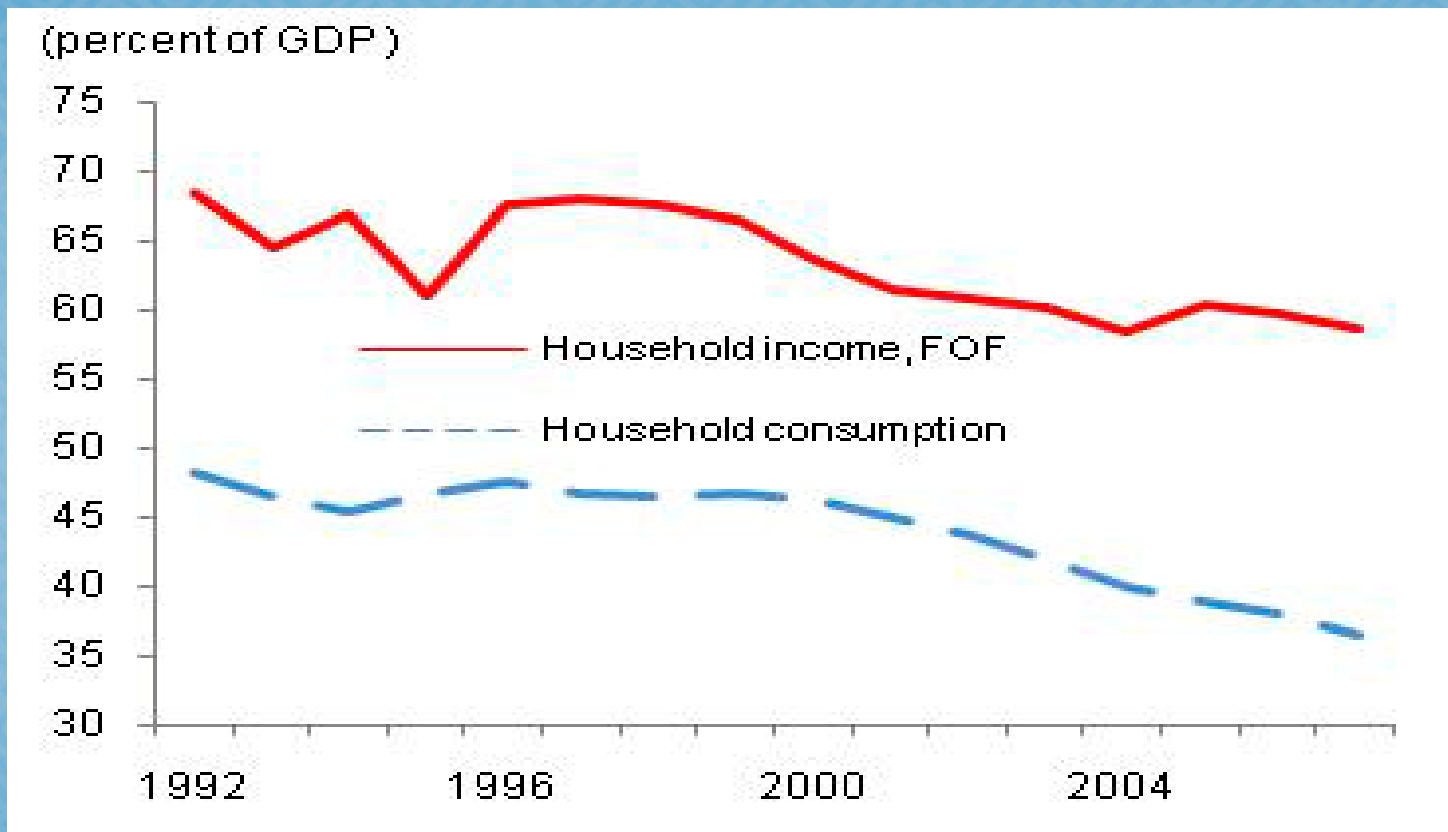
# But there are also drawbacks

- With the 11<sup>th</sup> 5 year plan (2006-10), a broadening of economic policy objectives
- Composition of growth has become a problem domestically and internationally

# Disadvantages of the capital intensive, industry-led growth

- Not enough urban job creation →
  - Not enough movement of labor out of agriculture
  - Urban-rural inequality has continued to rise
- Large and increasing share of income to firms and capital → low and declining share of income to households and wages
- Current account in increasing surplus
  - Complicates monetary policy and international relations
- Intensive in energy, raw materials, resources, and tough on environment

# Structure of the economy is key to increasing the role of consumption



Source: CEIC, World Bank estimates

# Rebalancing pattern of growth and raising role of consumption

- Shift away from industry and investment
- Shift towards services and consumption
- Note:
  - This is all relative
  - Should not be heavy handed
  - Can only happen over time
- But, the global crisis has increased the importance of rebalancing for China

# International perspective and experience

- Raising HH income/GDP and C/GDP
- Experience and lessons from OECD countries— from “watchman” to “guarantor”
- In 1970s, evidence of costs of too large governments became visible
- But the mandate of the government in providing social services and social insurance has remained untouched in OECD

# Composition of spending (% GDP)

	OECD 1/	Central	China 2/	
	2002	Europe 1995-2000	2000	2007
Total expenditure, <i>of which:</i>	40	41	22.0	24.8
Social security and welfare	15	14	3.9	5.2
Interest	4	3	0.7	0.5
Culture, edu., public health, science	12¾	12½	3.4	5.2
Gross fixed capital formation and capital transfers 3/	3¼	4½	8.6	6.4 4/

Sources: OECD, IMF, and World Bank



# Policies to rebalance and raise C—fiscal (I):

- Increasing government spending on health, education and social security
- Expanding the new SOE dividend policy
- Eliminating underpricing of industrial inputs—land, energy, water, natural resources, and the environment

# Policies to rebalance and raise C— fiscal (II): Taxes and Transfers

- Using fiscal policy to increase HH disposable incomes—consider lowering social security contributions
- Removing remaining distortions in the tax system that over-stimulate manufacturing
  - VAT
  - Other
- Introduce capital gains tax on equity

# Policies to rebalance and raise C—fiscal (III): Intergov. fiscal relations

- Introduce institutional reforms that give local governments stronger incentives and instruments to rebalance
  - Performance evaluation system
  - Local taxes
- Improve capacity poor local governments to fund public services

# Policies for rebalancing and raising consumption—other areas

- Exchange rate
- Financial sector
  - Remove cap on deposit rates
  - Improve access to finance service sector and SMEs
- Remove restrictions on service sector development
- Facilitate full, permanent migration
  - Land reform
  - Hukou reform
  - IGFS

# Progress to date?

- Important steps taken
- Limited progress in other areas—still a large agenda outstanding