

# China: Economic Performance And Policy Challenges

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# Discussion Topics

- Growth, trade and poverty reduction
- Sources of growth and near-term prospects
- Policy challenges for sustained growth over the medium term

# Growth, Trade, and Poverty Reduction

China has grown rapidly over the last 25 years from a very low income level.

- Average annual GDP growth 1980-2002: 9.5 percent
- Per capita GDP rose from about \$300 in 1980 to \$1000 in 2002
- In PPP terms, per capita GDP is now 10 times higher than in 1980.

# And there has been a substantial reduction in poverty

- An estimated 200-400 million people were lifted out of poverty since 1980
- According to the World Bank, much of the global poverty reduction during the last two decades was accounted for by China

# Growth has been accompanied by rapid expansion in external trade

- Exports grew by about 15½ percent a year between 1980-2002, China's share in world trade has expanded rapidly.
- Overall market shares to the G-3 have increased, while imports from within Asia have been increasing at fast rates, reflecting a high degree of vertical specialization.
- Strong domestic demand and further opening of the domestic market, have led to fast growth of imports.

# China has increased its market share in G-3 economies

## China's Market Share (Imports from China divided by total imports)

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	<u>1980</u>	<u>1990</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>
Japan	3.1	5.1	14.5	16.6	18.3
US	0.5	3.2	8.6	9.3	11.1
EU	0.7	2.0	6.2	6.7	7.4

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Source: DOT.

# China has become a more important export destination for Asian economies

Share of National exports going to China  
(In percent)

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	<u>1990</u>	<u>1995</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>
Japan	2.1	5.0	6.5	7.7	9.6
Malaysia	2.1	2.7	3.1	4.3	5.6
Thailand	1.2	2.9	4.1	4.4	5.2
Korea	0.9	7.3	10.7	12.1	14.6
Taiwan	0.0	0.3	2.8	3.9	7.6

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Source: CEIC.

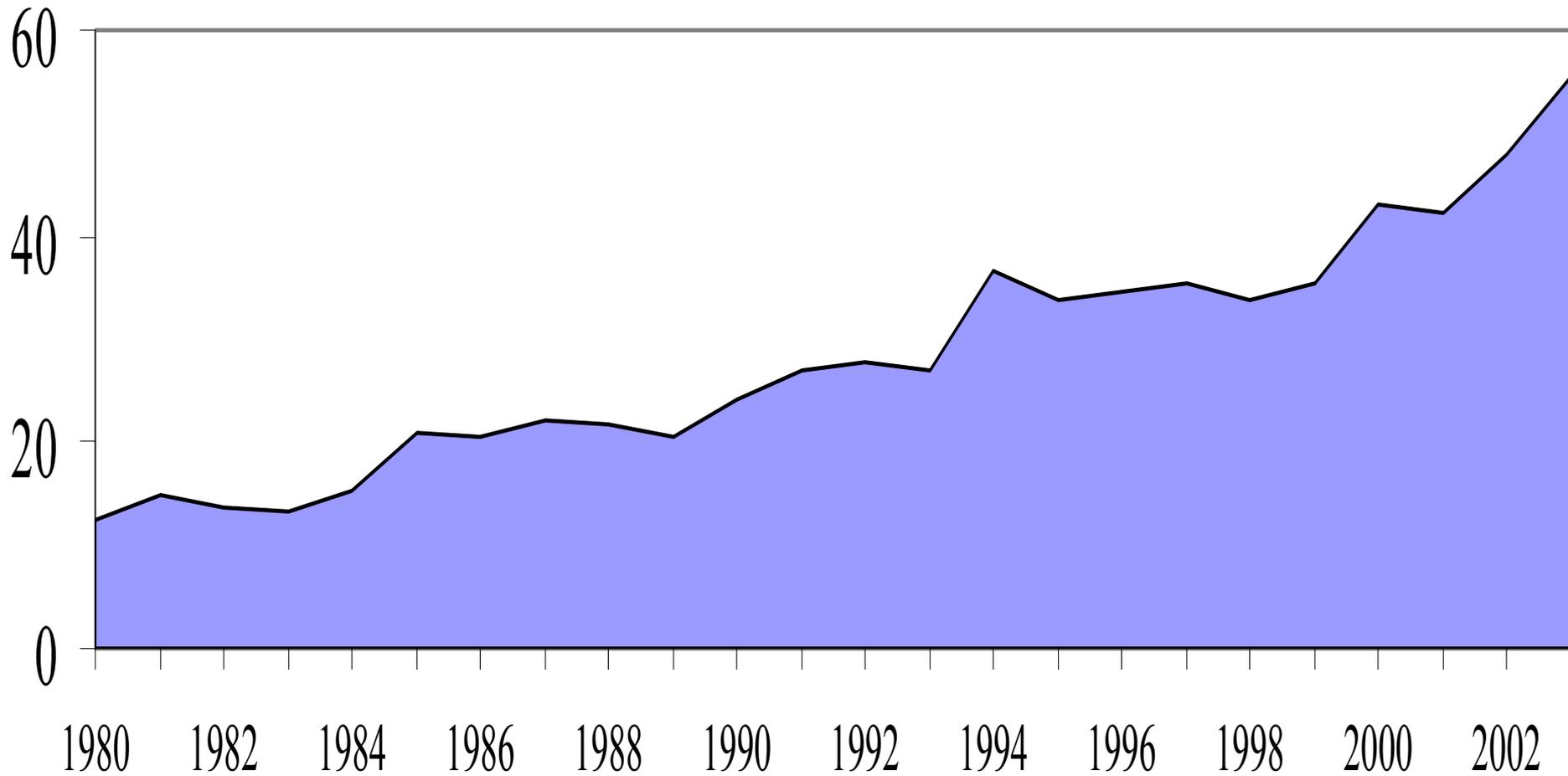
# Sources of Growth

- External trade and FDI have played an important role

Trade as a share of GDP rose from 13% in 1980 to 50% in 2002; FDI inflow was more than \$50 bn in 2002 (4% of GDP); Accumulated net FDI inflows since 1980 were \$440 bn.

- Domestic demand has also been strong, and the investment ratio has been very high.

# China: Trade As A Share of GDP, 1980-2003



## China: Investment As A Share of GDP, 1980-2002

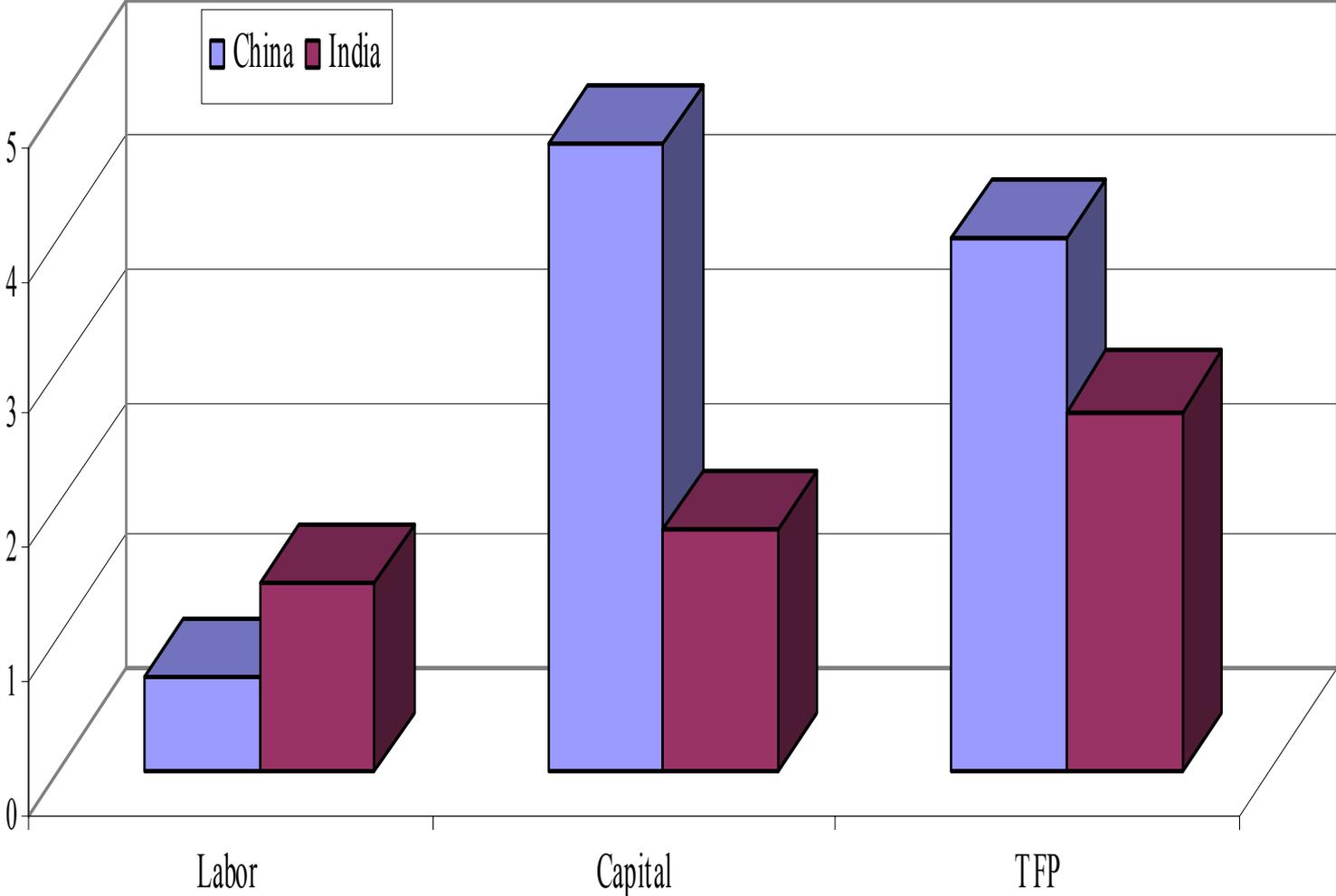


# Sources of Growth

Results from growth accounting exercises: (For example, Borensztein and Ostry 1996, Chow and Li 1999, Woo 1998, Heytens and Zebregs 2000)

- Capital accumulation accounted for the lion's share of GDP growth, 4½-7 percentage points a year;
- TFP growth has also been important, ranging between 2-4 percent a year during the reform period.

# Growth Accounting, 1990s, China and India (IMF Studies)



# Reforms with Chinese characteristics

- Pursuing gradual state sector reform while allowing/encouraging the development of the private sector
- Selective capital account liberalization (FDI)
- Trade liberalization and foreign exchange reforms

# Sources of Growth – the structure of the economy has changed

- Private sector now accounts for more than 60% of China's GDP, 2/3 of industrial value-added, from less than 1/3 in the late 1970s
- Foreign funded enterprises account for half of China's exports

# Near-Term Outlook

- GDP is projected to grow by 8½ percent in 2003, and 8 percent in 2004
- Trade and FDI are expected to continue their rapid expansion, in light of WTO accession
- External vulnerability is limited

# Medium-Term Prospects and Challenges

Medium-term prospects depend on how the following challenges are addressed:

1. Financial sector stability
2. SOE viability
3. Labor market pressures
4. Rural/Urban income disparities
5. Sustainability of the fiscal position

# Financial Sector Reform

## ➤ Progress:

Establishment and functioning of AMCAs

Building of Legal and regulatory framework

## ➤ Remaining challenges:

Disposal of large stock of NPLs

Reduction of accumulation of new NPLs

Strengthen supervision, risk management, and internal control

Diversifying ownership of SCBs

SOE reform

# SOE Reform

## ➤ Progress:

Abolishing planning; reduction of redundancy; mergers and bankruptcy; ownership diversification

## ➤ Remaining Challenges:

Monopolies in many sectors

Weak corporate governance

Excessive state involvement in management

Budget constraints not hard

Burdens of social functions and excess labor

Lack of good social safety net outside of SOEs

# Labor Market Pressures

- Further SOE restructuring will add pressure to urban employment
- Migration workers from rural areas are estimated to be more than 100 million
- Surplus labor in the rural sector is large
- Rigidities and segmentation hinders the effective functioning of the labor market

# Rural-Urban Income Disparities

Rural-urban income disparity has increased despite rapid overall growth. Need to address:

- Heavy taxation burdens on farmers
- Uncertainties related to land-use rights
- Obstacles to migration
- Need for education and health services
- Lack of formal social safety net in rural areas

# Sustainability of the fiscal position

- Budget deficit and official debt small

3 percent and 25 percent of GDP

- Quasi-fiscal liabilities are sizeable and demand for spending is rising

NPLs in the financial sector

Costs of pension reform and establishing other aspects of a social safety net

Heavy demand for more spending on health and education, especially for the lower income provinces.

# Concluding Remarks

Medium-term outlook depends critically on the pace of structural reforms. With necessary reforms implemented in an expeditious manner to address the challenges, China should be able to

- Sustain GDP growth at 7-8 percent a year
- Reducing NPLs in the financial sector
- Provide employment opportunities for the large labor surplus