

Comment: Growing with Capital Controls like China

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BOK-IMF ER Joint Conference
Asia: Challenges of Stability and Growth
Seoul, September 26~27, 2013



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Introduction

- **Global current account imbalances have narrowed after the GFC thanks to cyclical and structural factors (IMF WEO, April 2013)**
- **Still, it is hard to forecast the future path of global imbalances (GI) as we do not know which factors are dominant**
- **Understanding the mechanism causing GI is helpful in forecasting GI's future path**
- **The paper provides an alternative structural explanation of China's accumulation of large foreign reserves, making a good contribution to the literature on GI and EMEs' economic transition**

Summary of the Paper

- **Builds on the growth model of the 2011 AER paper**
 - The salient features of China's transition since 1992
 - High growth and sustained high returns on capital
 - Extensive resource reallocation (from SOEs to PEs)
 - Accumulation of large foreign surplus
 - Key assumptions or features of the model: heterogeneity between SOEs and PEs in two dimensions (financial frictions and productivity)
- **Extended to incorporate monetary and exchange rate policies with capital control to see the policies' role in the transition and their general equilibrium effects**

Comments

1. Model prediction of the GI path

- The model serves quite well as an explanation to the so-called "allocation puzzle" raised by Gourinchas and Jeanne (2009)
- However, some results regarding the path of trade surplus to GDP ratio appear somewhat implausible
 - The model, with or without policies, predicts that the trade surplus to GDP ratio rises and stays elevated even after the transition period is ended
- Need to relax strong assumptions, in particular PEs' no access to financial markets, for the model to give some practical clue about the GI's future path

Comments

2. Financial reforms and the pace of transition

- The model predicts that the transition proceeds only gradually because PEs have to resort to retained earnings for investment
- Will financial reforms accelerate or deter the transition? → Quite uncertain, as heightened market accessibility and lowered funding costs may have opposite effects
- Again, it will be a productive extension if the model includes policies regarding financial reforms and simulates the effects of different financial policies (Remind that financial reforms in EMEs have been debated to have important implications for GI)

Comments

3. Changes in industrial structure (demise of SOEs?)

- The model appears to explain quite well the fact that, in China, resource reallocations have taken place in labor-intensive industries where profitable PEs have driven out inefficient SOEs
- But SOEs still thrive in capital-intensive industries and may have some dynamic efficiency
- The existence of large-scale enterprises that are inefficient initially but financially integrated may be a critical precondition for China to transform itself into a more sophisticated economy (look at Korea's case and the role of its conglomerates in the process)

Comments

4. The increasing employment share of PEs

- The theory hinges on that resource reallocation, esp. labor, has been dramatic since the early 1990s
- It may reflect not only the inter-sectoral reallocation, but also that China has much room to go until it reaches the Lewis Turning Point (According to Das and N'Diaye (2013), it will be 2020~2025)
- If the latter is dominant force, subdued wages make PEs, mostly operating in labor-intensive industries, more profitable
- This can explain why PEs' profitability can be higher than capital-intensive SOEs, and sufficiently high to trigger transition

Comments

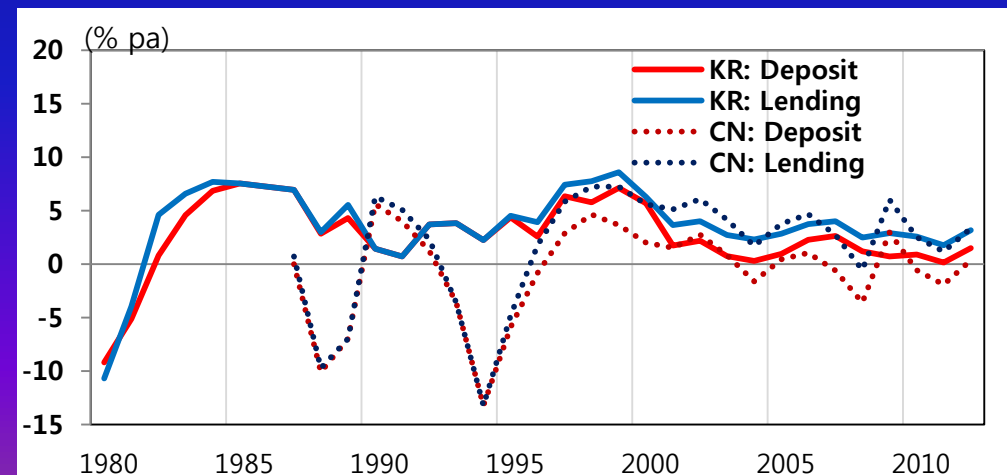
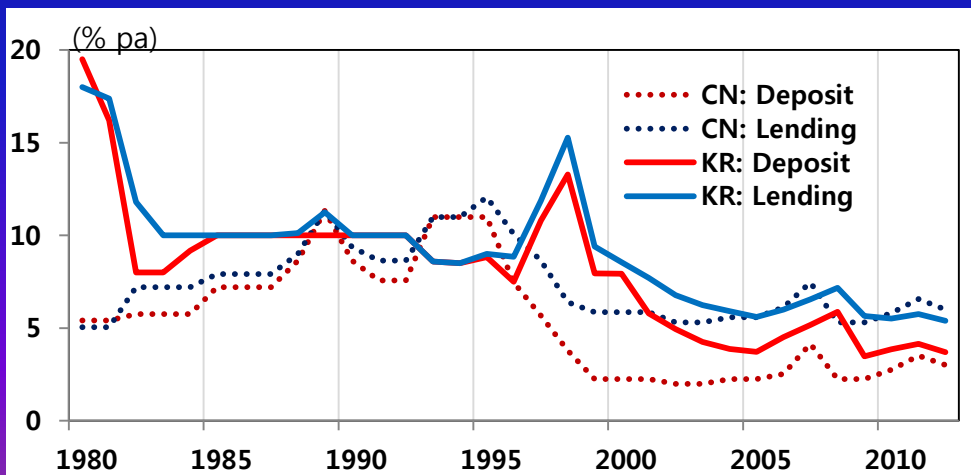
5. The role of monetary policy: high or low interest rates

- Real interest rates in China has been higher than in the global market due to capital control
- But considering its stage of economic development (e.g. compared to Korea), interest rates are not that high, raising the possibility of the role of low (not high) interest rates for growth

Deposit and lending rates in China and Korea

(Nominal)

(Real)

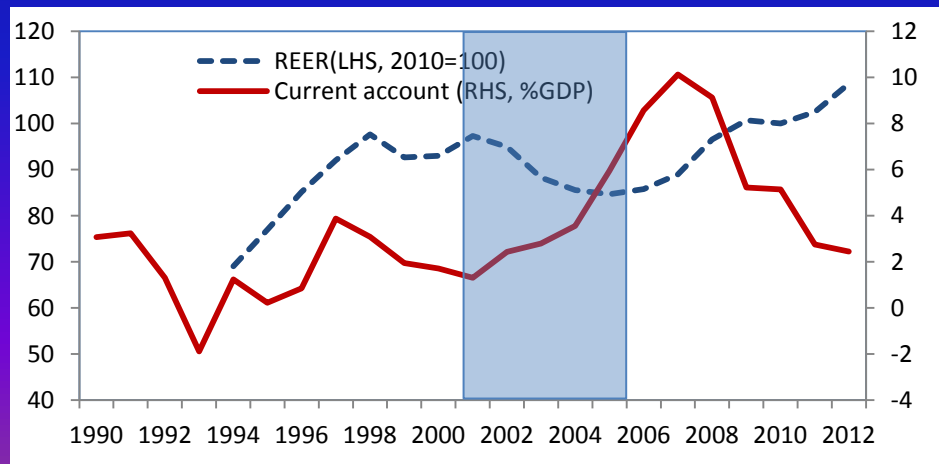


Comments

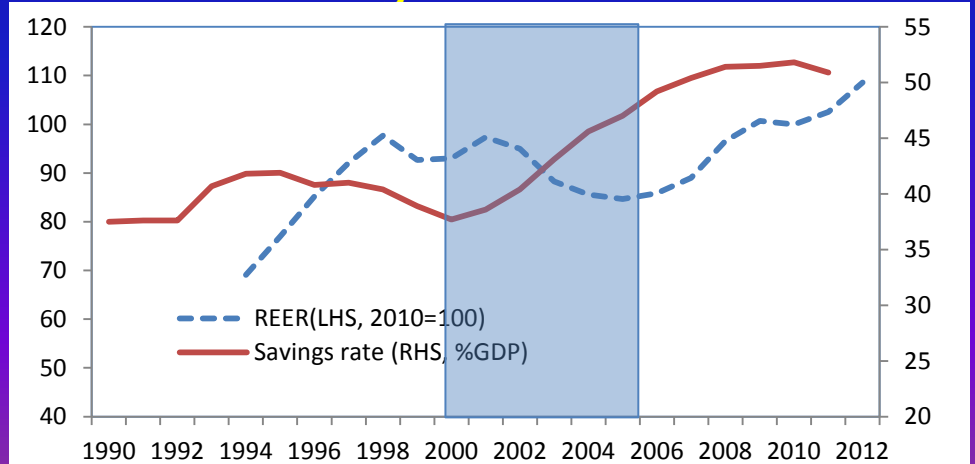
6. The role of exchange rate policy: savings vs. export

- Positive relationship between REER anticipation and trade surplus in line with the theory's prediction (expectation of real appreciation delays consumption and more savings are induced)
- But the periods of 2000~2005 and after the GFC are exceptions, suggesting other channels (e.g. depreciation causing higher trade surplus and corporate savings)

Current Account and REER of China



Gross Savings Rate and REER of China





Conclusion

- The paper offers insightful alternative explanation of China's accumulation of large foreign reserves and economic transition
- The theory seems to have large potential to extend on many fronts
- The most fruitful avenue seems to be the extension of the model to accommodate financial deepening (e.g., PEs' better access to financial markets) and simulate the effects of financial policies on savings and trade surplus

THANK YOU!



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