

Washington State Department of Commerce

Survey of the Chinese Economy

and Connections with Washington State

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May 25, 2011



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Overview

- Survey of Chinese economy and recent growth, issues, and trends
 - Broad growth trends over past three decades
 - Is China getting more expensive?
 - Other key inputs: land and capital
 - What does “urbanization” mean in China?
 - Does the state sector still matter? (Spoiler—you betcha!)
- Where does Commerce see opportunities?
 - Outbound FDI
 - Exports



Important topics I will not cover today...

- Local government debt and local government investment companies
- China's 2008-2010 stimulus
- The exchange rate and other RMB-related issues
- Taiwan, other sovereignty and geopolitical issues
- The Strategic and Economic Dialogue (S&ED)
- And plenty of other stuff...



What drives economic policy decision-making in China? And the internal debate.

- Employment (National Development and Reform Commission, MOFCOM)
 - Support for tradable goods sector (e.g. exchange rate policy, credit allocation, etc.)
- Inflation (PBoC)
 - Limited ability to control. People's Bank of China does not have a fully independent monetary policy.
 - Monetary policy oriented around sterilizing excess liquidity created by undervalued RMB.
 - Must resort to “window guidance” and administrative measures to stem bubbles, e.g. 2010 (largely ineffective) regulations on housing purchases.
- Social stability (stemming from the above two)
 - Growth in local uprisings against illegal land takings and/or unsatisfactory compensation, environmental degradation, and corruption



What's driving growth in China? The debate.

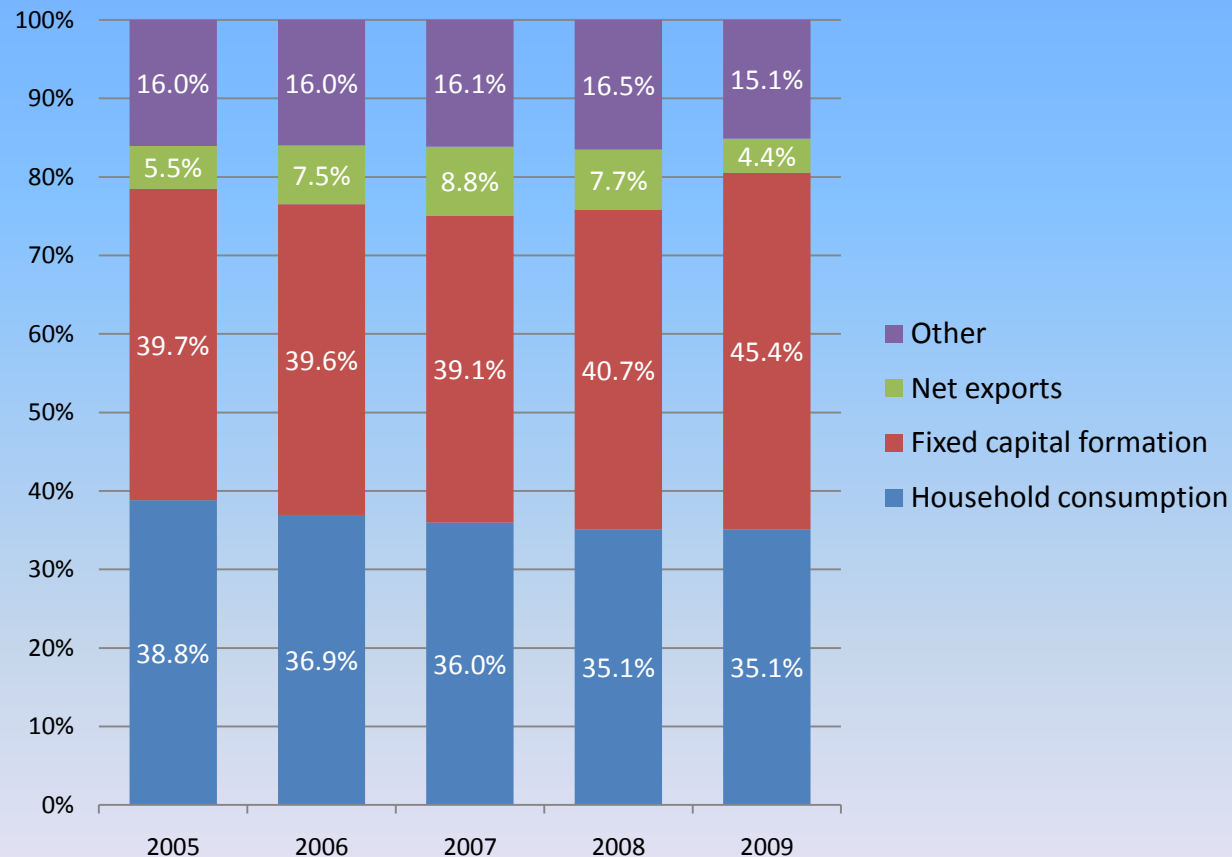
- Louis Kuijs,¹ World Bank, 2009: between 1995 and 2009, 5.5ppt from capital accumulation, 2.7ppt from total factor productivity (TFP).
- Bosworth and Collins,² 2007: TFP grew at 3.8% per year, responsible for 2/3 of growth during reform period.
- Brandt and Zhu,³ 2010: rising TFP in the non-state, non-agriculture sector the main driver of growth.
 - If capital was more efficiently allocated, China could maintain high growth without further capital deepening.
- Alwyn Young,⁴ 2003: TFP grew only 1.8% between 1978 and 1998.
 - That China essentially followed the low-efficiency growth of other Asian economies
- European Union Chamber of Commerce,⁵ 2009: investment the biggest driver.



China's growth model—some broad trends

- Household consumption at historical, record lows (as share of GDP; 35.1% in 2009)
- This does not mean that consumption is not growing, but that it is growing *much slower than* investment past couple years.

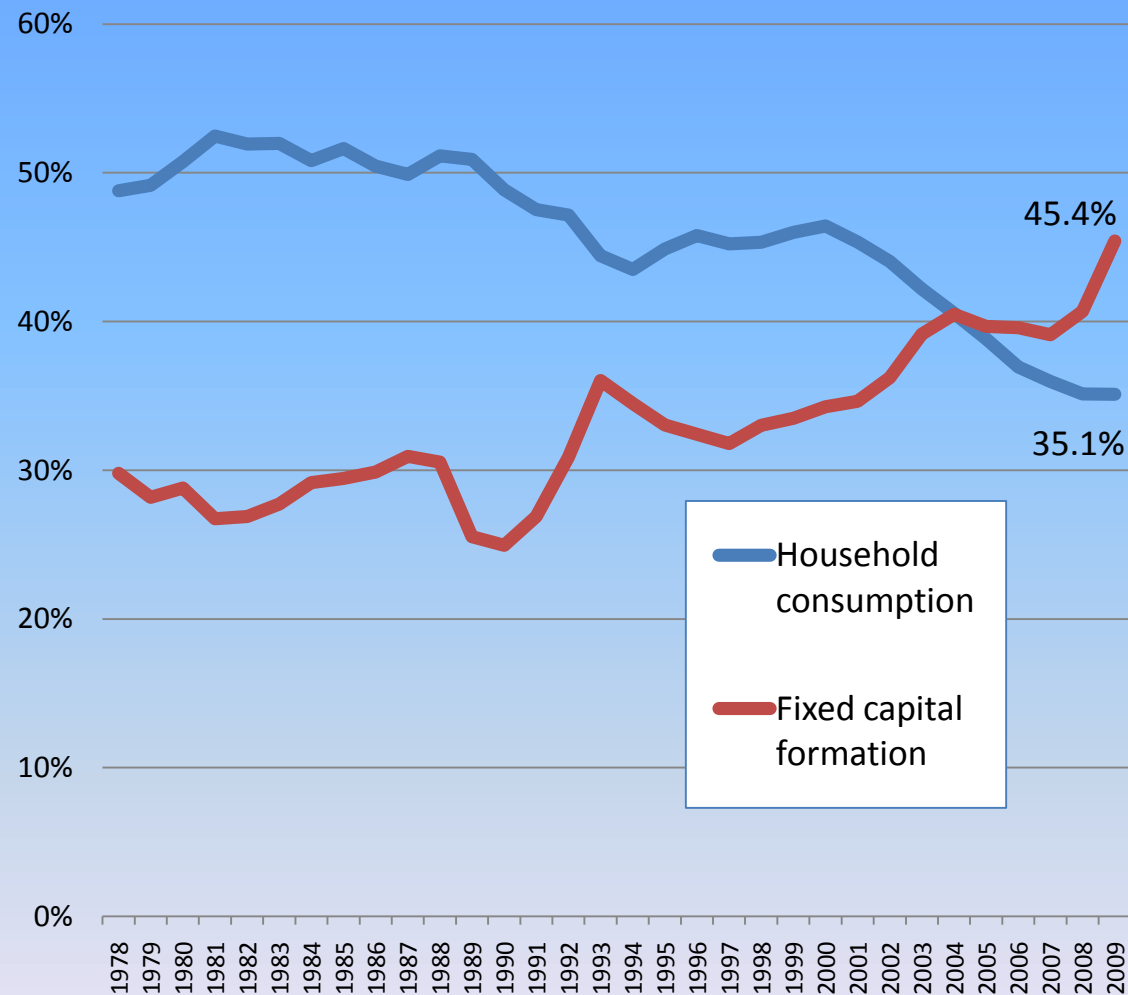
Composition of GDP, 2005-2009



Gross fixed capital formation and household consumption

Share of GDP, 1978-2009

- **Perspective:** If China wants to achieve a consumption/GDP ratio of 0.6 in 15 years **and** maintain real GDP growth of 8% per year, consumption would need to grow *4 percentage points faster per year* (not the trend we've seen of late)
- To reach a consumption level of 70%, that rate would need to be more than 5 percent points faster



Issue #1: Wage Growth, but When and How?

THE OUTLOOK | By Shai Oster

China's Rising

HONG KONG—Wages are rising in China, heralding the possible end of an era of cheap goods.

For the past 30 years, customers would ask William Fung, the managing director of one of the world's biggest manufacturing-outsourcing companies, to make his products—whether T-shirts, jeans or dishes—cheaper. Thanks to China's seemingly limitless labor force, he usually could.

Now, the head of Li & Fung Ltd. says the times are changing. Wages for the tens of thousands of workers his Hong Kong-based firm indirectly employs are surging. He predicts overall, China's wages will increase 80% over the next five years. That means prices for Li & Fung's goods will have to rise, too.

"What we will have for the next 30 years is inflation," Mr. Fung said. "A lot of Western managers have never coped with inflation."

The issue is likely to hover behind talks Monday, between Chinese and U.S. leaders in Washington at their annual Strategic Economic Dialogue. Currency and debt issues are expected to dominate the agenda. But there are signs that the low labor costs—and cheap currency—that led to China's huge trade surplus with the U.S. could be reaching a tipping point. This comes amid



name of **Hon Hai Precision Industry Co.**, maker of iPads for **Apple Inc.**, and computers for **Hewlett-Packard Co.**, among others. After a string of worker suicides last year at one of its China plants spurred Foxconn to defend its treatment of employees, the company raised wages 30% or more in a bid to



新闻 评论 专题 周末版

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野村证券: 农民工短缺有助经济结构调整升级

本文来源于《财经网》 2011年03月01日 14:14 共有0条评论

3月1日, 野村证券关于经济结构

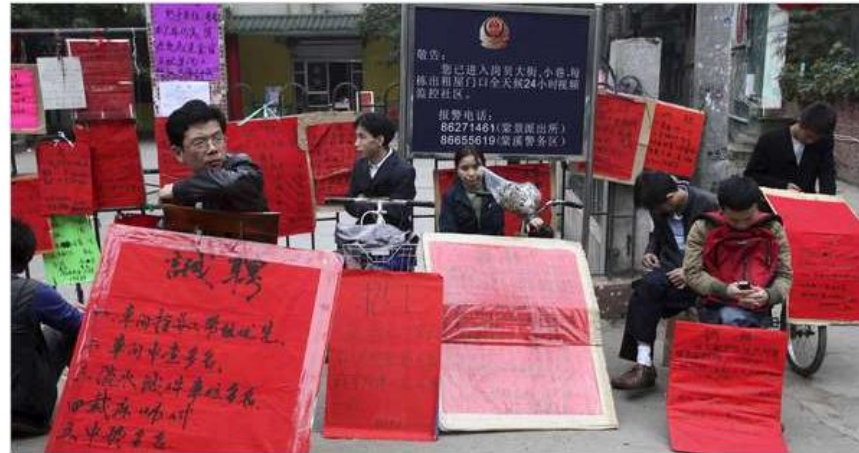
【财经网】目前中国市场

野村证券在和建筑业, 示, 这种现象

首先, 由内和跨国企业成本较高, 从

其次是人的比例在过去的增长越来越

Defying Global Slump, China Has Labor Shortage



Joe Tan/Reuters

Employers sit with recruitment posters on a street in Guangzhou. China's coastal industrial heartland is facing a severe labor shortage as many migrant workers have not returned.

By KEITH BRADSHER
Published: February 26, 2010

GUANGZHOU, China — Just a year after laying off millions of factory workers, [China](#) is facing an increasingly acute labor shortage.

MarketWatch

May 9, 2011

1:43 PM EDT

New York London Tokyo

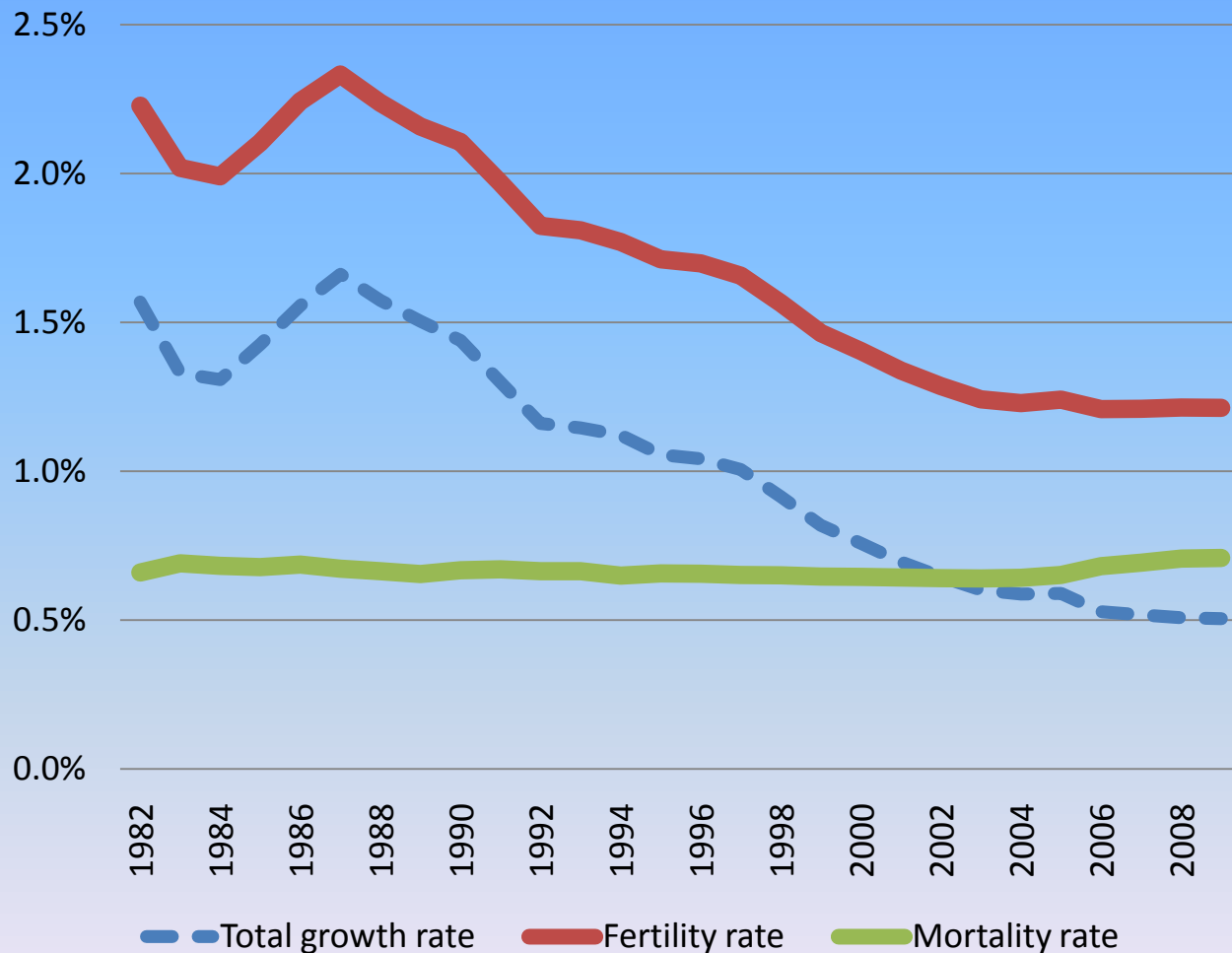
1:33p Activision, Sotheby's results on after-hours deck	DOW	+61.68	NASDAQ	+18.58	S&P 500	+6.66
1:31p Euro falls after rating cut on Greece			19%	2,846.14	+0.66%	1,346.86
1:25p Treasury yields head toward 2011 lows over Greece						+0.50%
1:15p Airline stocks wither as oil recovers						

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An Aging Population



- Impacts of the One Child policy are now being felt
- Eventual reduction in size of working age population and upward pressure on wages.
- Growing strain on social security system with fast growing number of retirees—sound familiar?



Lewis Turning Point

- Basic idea is that, as economy develops, significant productivity gap between traditional (i.e. non-technical agrarian) and modern (aka capital-intensive/manufacturing) sectors, significant surplus rural labor.
- As (usually urban) manufacturing sector grows, factory managers able to tap into seemingly limitless supply of rural/traditional sector excess labor → downward pressure on wages, despite high growth → high corporate profitability and retained earnings.



But are we there yet?

- In China, despite 30 years of growth, manufacturing wages have only recently shown signs of (real) growth.
- Many scholars argue that the Lewis Turning Point is upon us.
- But, has China really fully tapped out labor supply? (Has demand finally outpaced new supply?)
- Maybe not—other considerations, notably the household registration system, or “hukou.” (More on this later.)
- If China were to “free up” institutional constraints on permanent rural-urban migration, this could prolong period of low-wages.



Issue #2: Urbanization

- What does urbanization mean in China?
- Who is “urban”?
- Shenzhen has per capita GDP of \$10,000 if you *exclude* all the people making GDP!

SZ per capita GDP exceeds US\$10,000

Latest Updated at 2008-January-30 16:39:59

Shenzhen has worked another wonder by becoming the first city on the Chinese mainland to have its annual per capita gross domestic product (GDP) surpass US\$10,000.

The city recorded a per capita GDP of US\$10,628 in 2007, the municipal statistics bureau said at a press conference Tuesday.

According to the World Bank, per capita GDP of US\$10,000 is considered as a threshold for an economy to be regarded as "developed."

The city's GDP grew 14.7 percent over 2006 to total 6,765.41 billion yuan (US\$939.64 billion) last year, according to statistics released at the conference.

Counting the city's permanent resident population, which stood at 8.6155 million last year

Related News

- 'Shenzhen needs innovation systems'
- Shenzhen scientists join genome project
- Shenzhen gets new Party secretary
- Pre-owned property prices drop in Shenzhen

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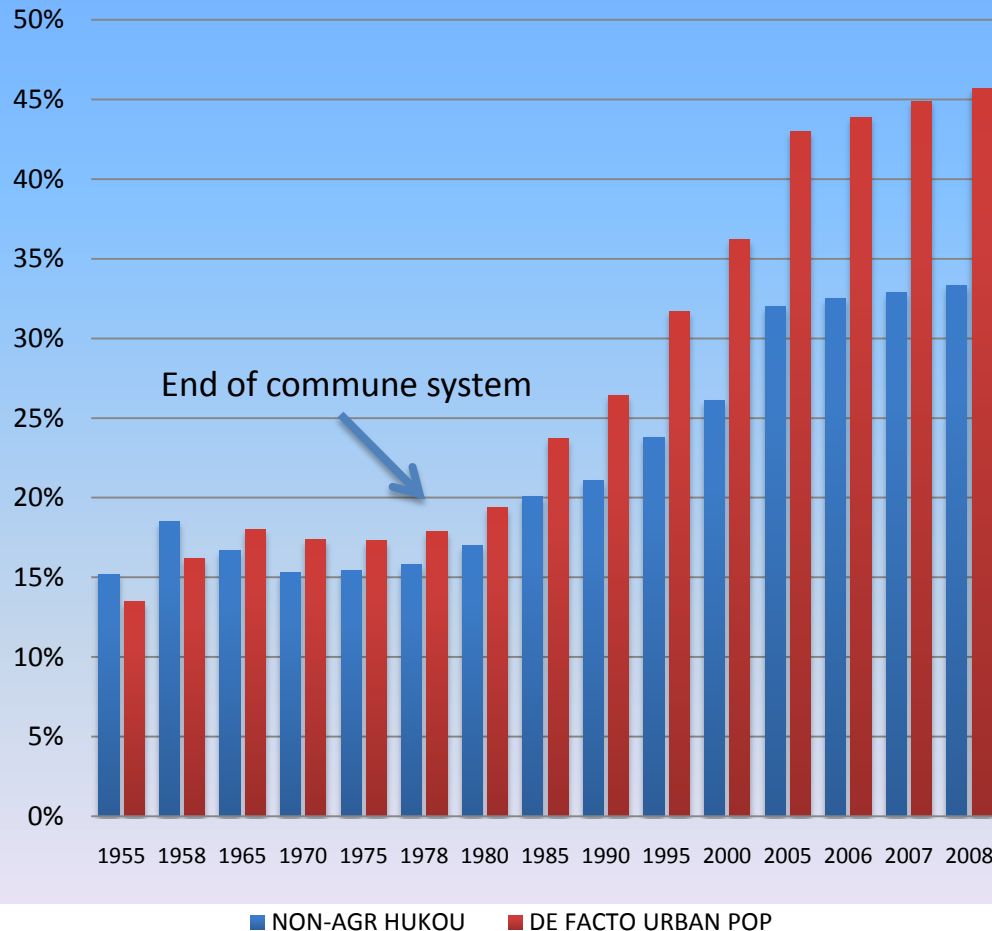
Shenzhen per capita GDP breaks US\$10,000 mark

By STAFF EDITOR
Published: January 31, 2008 01:00 AM
Shenzhen became the first city in mainland China to register a per capita GDP in excess of US\$10,000 after total economic output grew 14.7% to US\$94.04 billion (RMB676.64 billion) last year, the China Securities ...



Issue #2: Urbanization

Official and *de facto* Urbanization*



- The “devil’s in the details”
- China is urbanizing, but this only “partial” urbanization—majority of 150+ million migrants are temporary.
 - Cannot get full, permanent status as urban residents, due to *hukou* system.
 - Significant mismatch between housing prices and those that actually need housing.
- Large debate about how China should urbanize going forward.



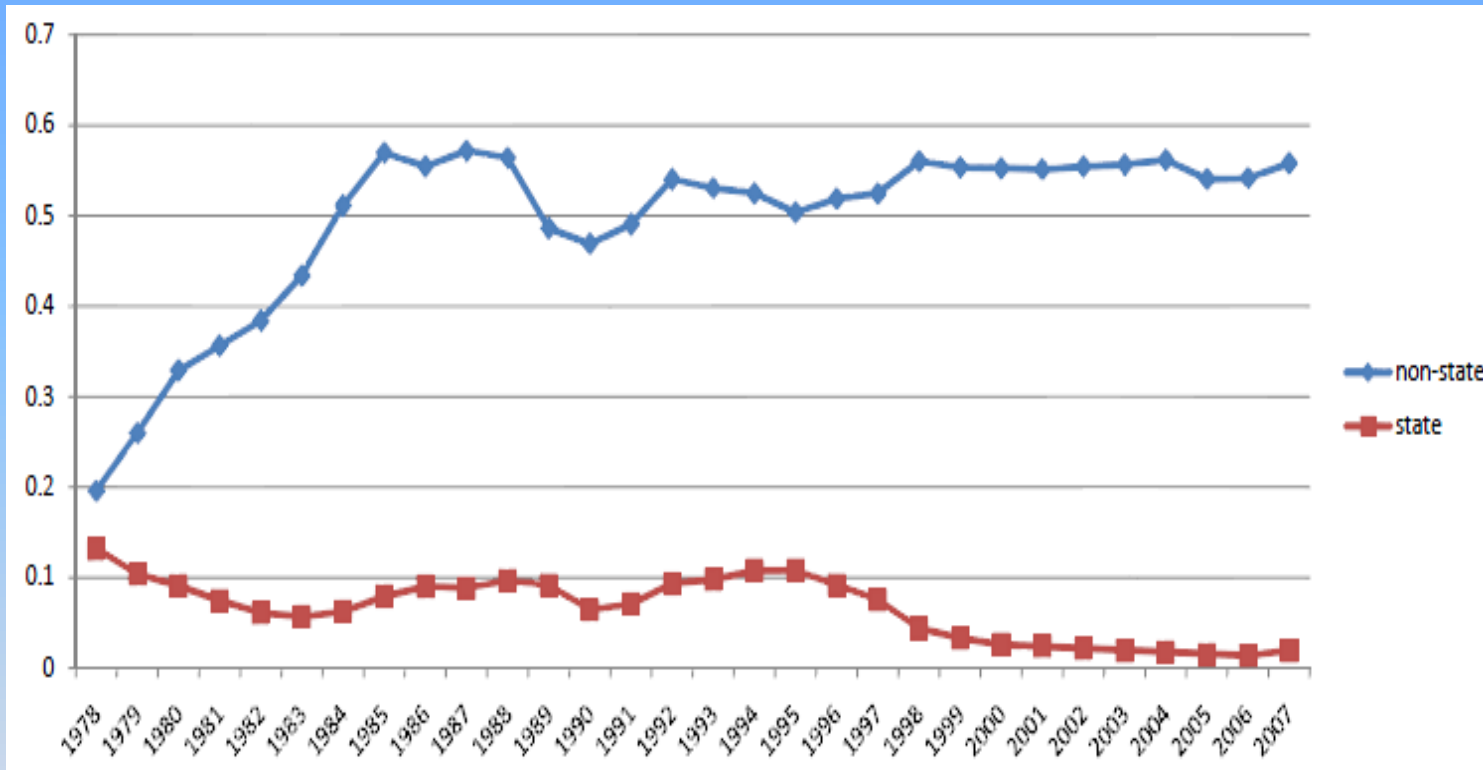
Urbanization (cont.)

- Today, significant stratification between “local, urban” hukou population and *nongmingong* (rural-to-urban migrant workers) with limited rights.
- Migrants do not have access to many public goods, e.g. education for children and state-subsidized affordable housing.
- Many cities now “sell” local hukou as revenue stream, e.g. one can purchase a new home, luxury home and pay hukou transfer fee.
- Obstacles mean finite period of stay for most migrant workers, e.g. 5-7 years, before (very reluctant) move back to village
 - This limits labor supply and has a positive effect on wages.



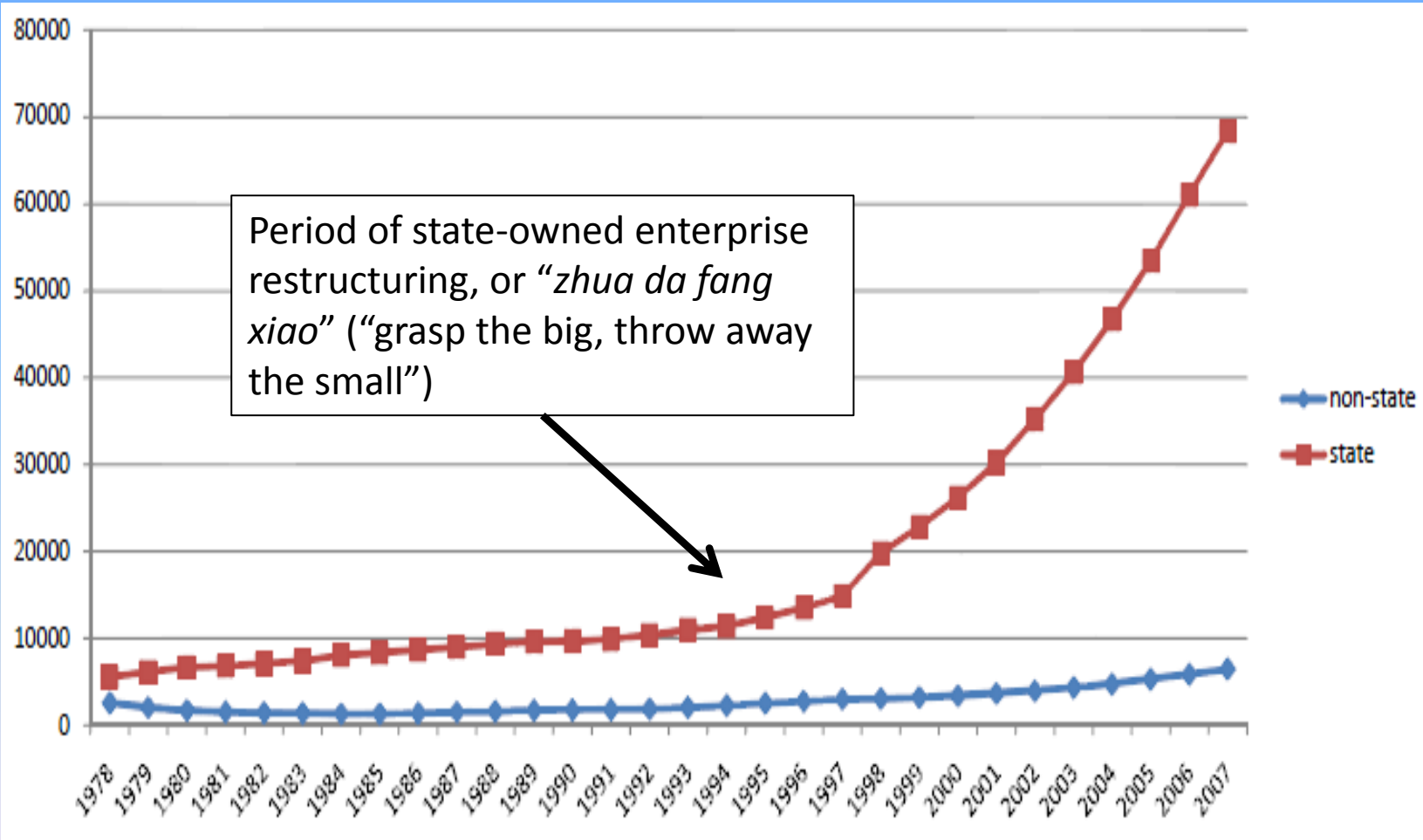
Issue #3: State Capitalism

Returns to capital strongly favor the non-state sector, but...



Total factor productivity (TFP) gains show a similar story, with agriculture showing the most growth, followed by the non-state manufacturing sector.

...look where capital is going



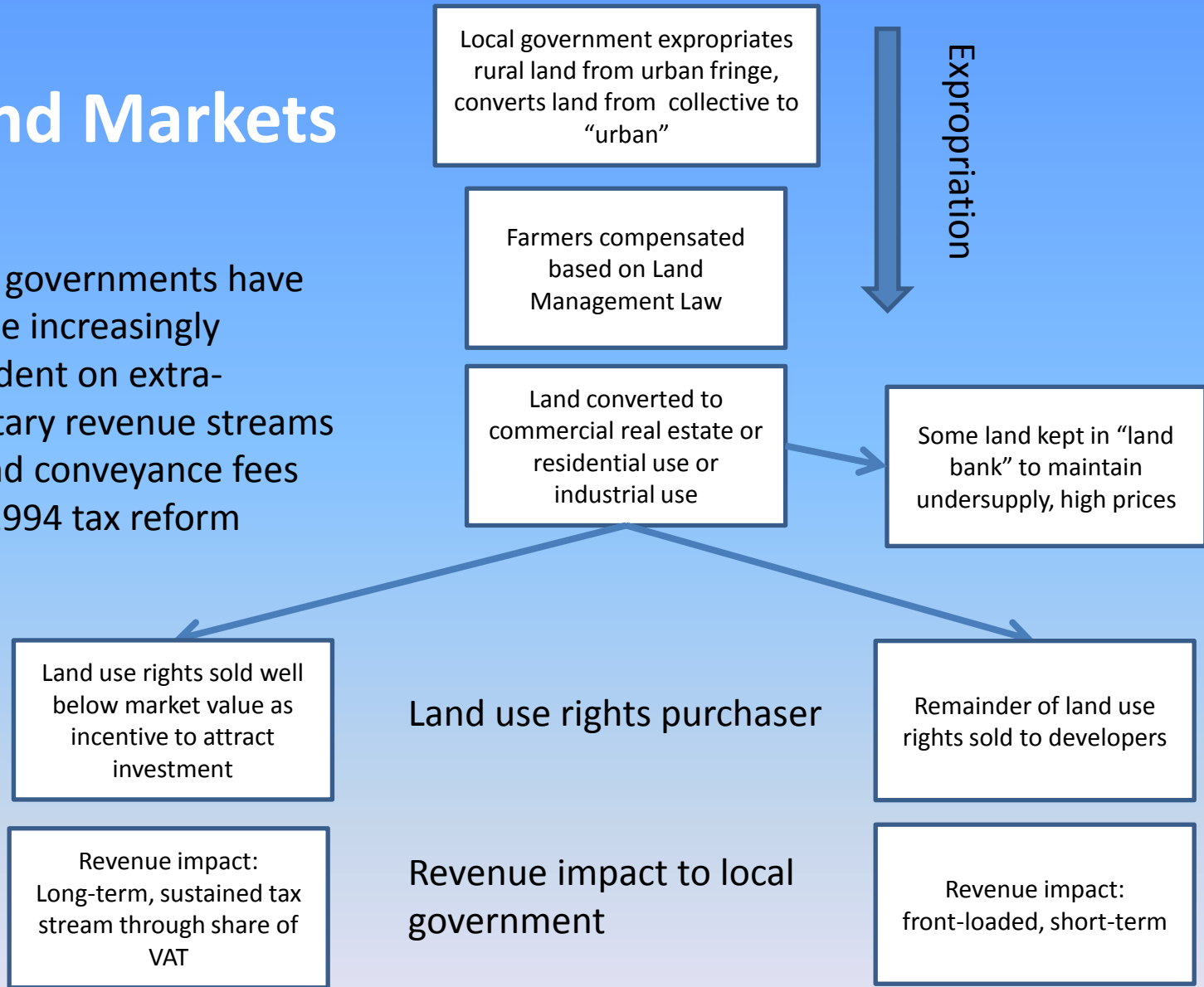
Capital

- State banking system continues to favor state enterprises over private enterprises (which are driving growth)
 - Private sector firms often have to go to informal markets for credit, with higher rates.
- Due to financial repression, households have few alternative places to store earnings other than deposit accounts, which pay below inflation rate (one alternative for wealthier households: real estate)
- This enables cheap credit for lending to tradable goods sector, forces households to effectively subsidize manufacturing sector.
- Higher interest rates on deposits could actually support more household consumption through wealth effect.



Land Markets

- Local governments have become increasingly dependent on extra-budgetary revenue streams like land conveyance fees since 1994 tax reform



Some Brief Conclusions

- The state matters!
 - The state influences the prices of land and capital, and the size and mobility of the labor force.
 - Recent policies like “Indigenous Innovation,” though momentarily withdrawn, reflect protectionist tendencies.
 - Window guidance measures to control inflation in the absence of a truly independent central bank.
 - System that encourages/supports transfer of wealth from households to state-owned manufacturing sector.
- China data can be useful, but understand it before drawing conclusions.

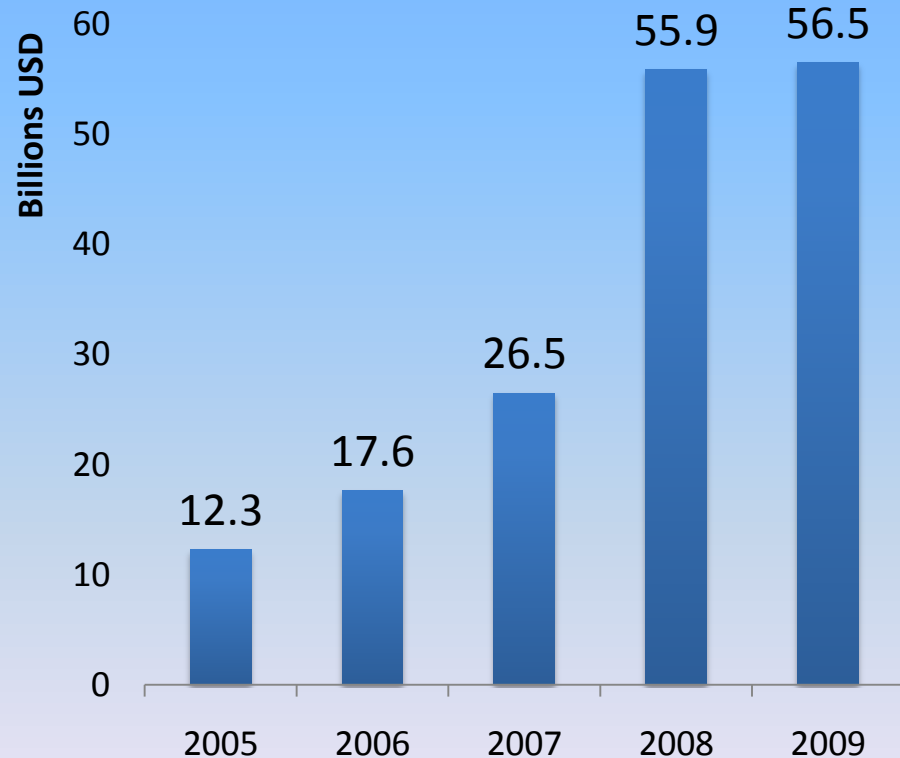


Outbound FDI

- Much excitement lately about Chinese outbound FDI, but where is this going?



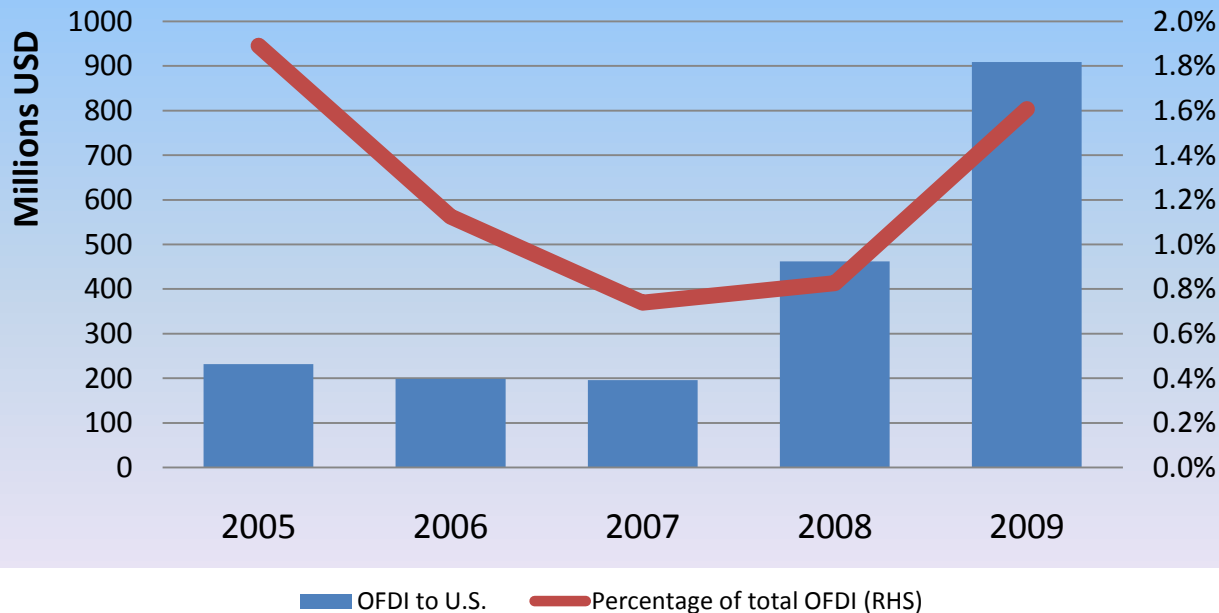
Chinese (non-financial) Outbound FDI



Outbound FDI

- To date, mostly resource plays, some M&A.
- U.S. (as of now) not a major recipient, though some recent wins in Washington.

Chinese (non-financial) Outbound FDI to U.S.



OFDI—Washington’s Experience

- Some recent “wins” — GCL Solar (2009) and Mindray Medical (2006)
- **Challenges:**
 - Most investors opaque about investment objectives
 - Unrealistic expectations for how the state can help “choose” investment targets.
 - Still in learning phase of process
- Growing interest in EB-5 program



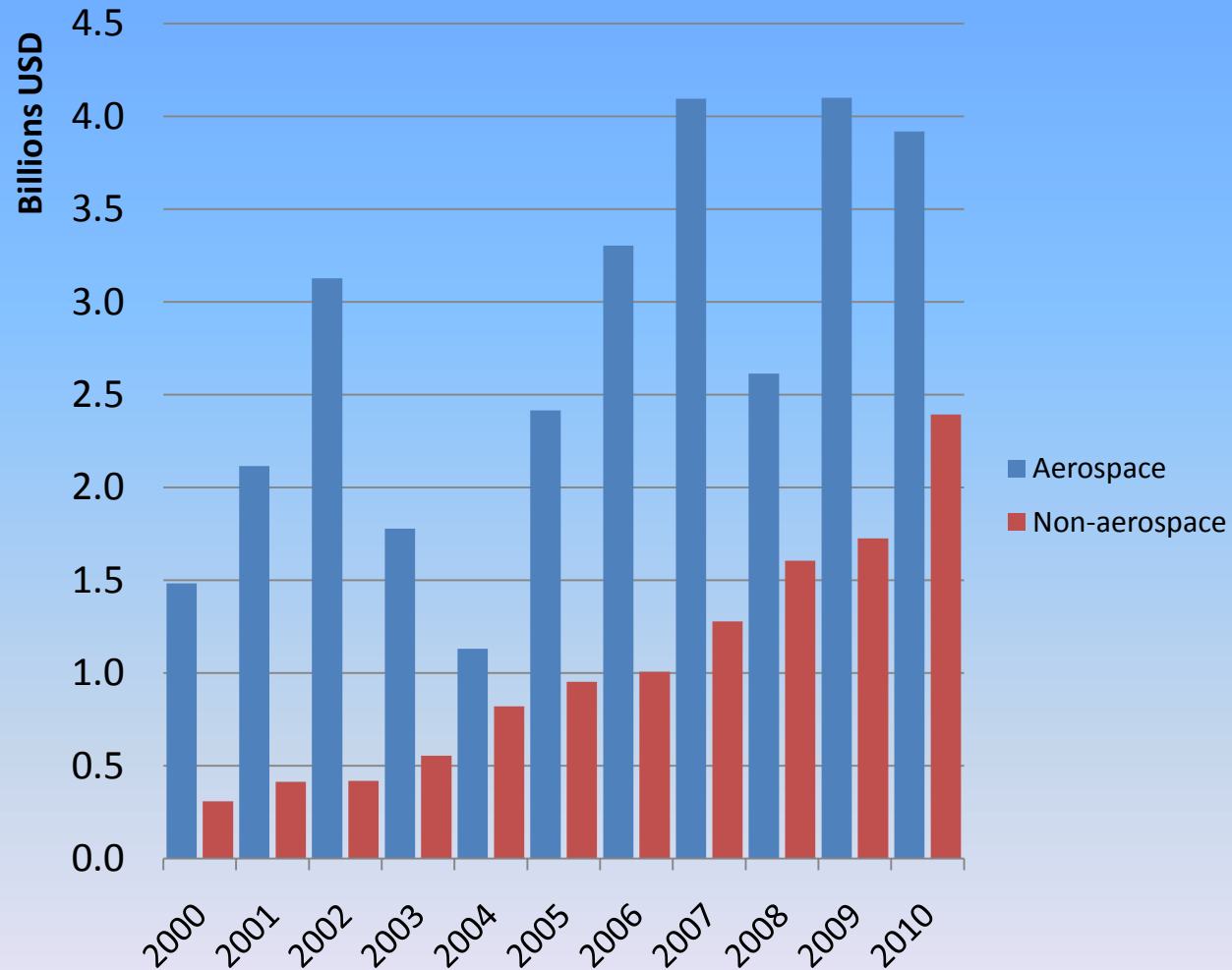
Exports: China is a Major (and Fast Growing) Export Market for Washington

- From 2009 to 2010, non-aerospace exports (excluding soy, corn, and rice) to China grew **38.6%**, equal to 18.2% of gross export increases to all foreign markets.
- Exports are a mix of commodities (e.g. wood and scrap metals) and high tech goods (e.g. aircraft and ultrasound equipment)
- **Aerospace** exports to China peaked at \$4.1B in 2009, and reached \$3.9B in 2010—still Washington’s biggest single market (Japan is second, at \$2.3B).

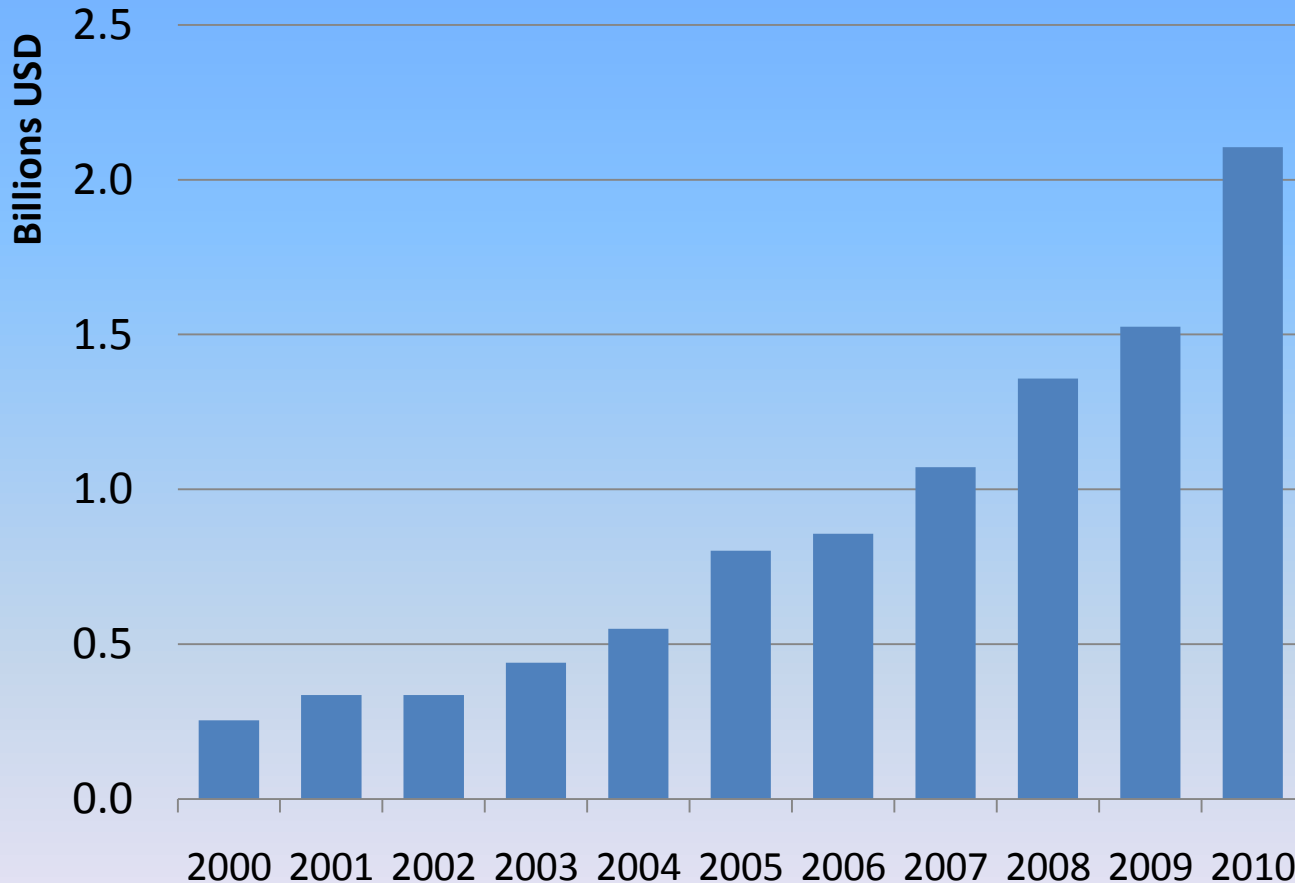


Washington's trade with China

- Non-aerospace exports have consistently increased over the past decade
- Non-aerospace exports have grown at a per annum rate of **22.8%** between 2000 and 2010 (in nominal USD)



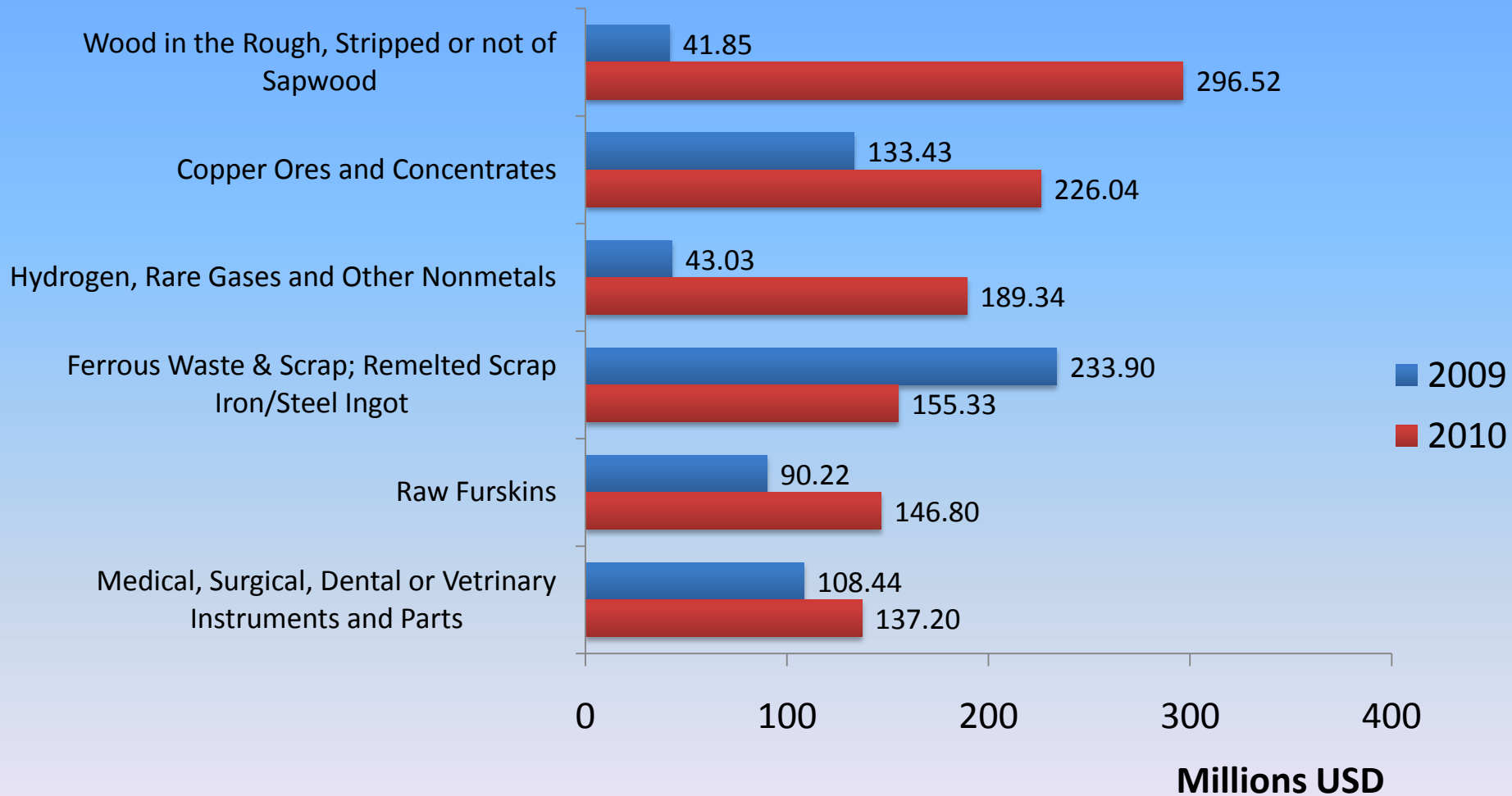
Washington's non-aerospace, non-agriculture exports to China



- [Medical device exports](#) grew 553.7% from 2001 to 2010, a per annum rate of 23.2%
- Ultrasound equipment exports grew at an average annual rate of 68.6% between 2001 and 2010.



Washington's Top non-Aerospace Exports to China, 2010



For more detailed discussions of Washington's exports...

- Quarterly publication
- General export trends, plus detailed analysis by product and/or market.
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Commerce Quarterly Trade Bulletin

Vol. 3, No.1, April 2011

Year in Review—2010

The economy's been out of recession (officially) for six quarters, and global trade is back up, after a dismal 2009. And the big change in Washington's exports was (drum roll)...0.6%. So while U.S. exports surged almost 21%, Washington exports grew...0.6% (Figure 1). But what's behind this seemingly laggard growth? It's all about aerospace, which fell 11.9% in 2010 (Figure 2). In a telling calculation, the decline in aerospace exports made up roughly 84.9% of the total gross declines in exports in 2010. Non-aerospace exports actually grew 17.2%; stripping out agriculture and food (which grew 14.9%), remaining exports (the non-aerospace, non-agriculture segment, or "NANA") grew 18.2%. So what drove the decline in aerospace, and conversely the surge in everything else? In aerospace, sales to Washington's top five markets in 2009 fell a collective 23.8% in 2010, with only Japan showing positive growth (16.8%)—the biggest drop came from the UAE, a 71.2% decline. But one can't forget the cyclical nature of aerospace exports, which are influenced by not only long-term airline industry forecasts, but also delivery lead times, the age of existing fleets, and other factors dissimilar to those affecting broader export flows.

Among the remaining, non-aerospace exports, industrial machinery led the way with 26.4% growth in 2010, constituting 10.8% of all increases for 2010. The biggest increases included forklifts (\$257.5 million, 141.9% growth) and machines for the manufacture of semiconductors (\$109.4 million, 403.0% growth). Other drivers of export growth included wood products (11.9% of all growth), and inorganic chemicals, rare earth metals, and radioactive compounds, at 11.0%, with sizable year-over-year increases in silicon and uranium (going to Japan and Taiwan).

Figure 1. Washington's Goods Exports, Annual

Data source: WISER Trade



Year	Exports (Billion USD)
1996	224.5
1997	231.1
1998	237.6
1999	225.9
2000	221.9
2001	222.8
2002	232.7
2003	222.2
2004	227.0
2005	220.5
2006	239.9
2007	248.7
2008	248.6
2009	246.4
2010	246.6

In This Edition

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Notice: As an annual tradition, we think it's important to emphasize the limitations in state-level export data. For one, we're only talking about merchandise and commodities, i.e. goods exports. This means this data does not include services exports, which the Washington State Office of Financial Management's Input-Output Model estimated to be almost \$17 billion in 2002, and we're pretty sure this number has only grown since. Services exports range from software licensing, legal and architectural services to tourism and tuition fees paid by foreign nationals. In fact, anytime a foreign non-resident comes into Washington and buys something, it's an export, though these in-state transactions are not trackable at the state level.

Second, state export data only covers goods exports declared at customs; anything under \$2,500 in value in most cases would be not counted (and consider all the purchases made by weekend Canadian shoppers in northern Washington). Third, exports are reported in nominal terms—they are not corrected for inflation and fluctuations in the U.S. dollar relative to other currencies. Lastly, as we've stressed many times, our export estimates are in fact a correction on the official U.S. Census Bureau's data—we think it's important to remove goods that are only consolidated here and originate elsewhere, e.g. soy, corn, and rice. We also refrain from talking about state-level trade balances. The current data limitations do not allow for a meaningful calculation of state-level imports.

For a more detailed explanation, see [Andrew Cassey, PhD, Trends in Washington Exports](#), webinar, Washington State University.

Commerce Quarterly Trade Bulletin, April 2011 | 01



Thank you

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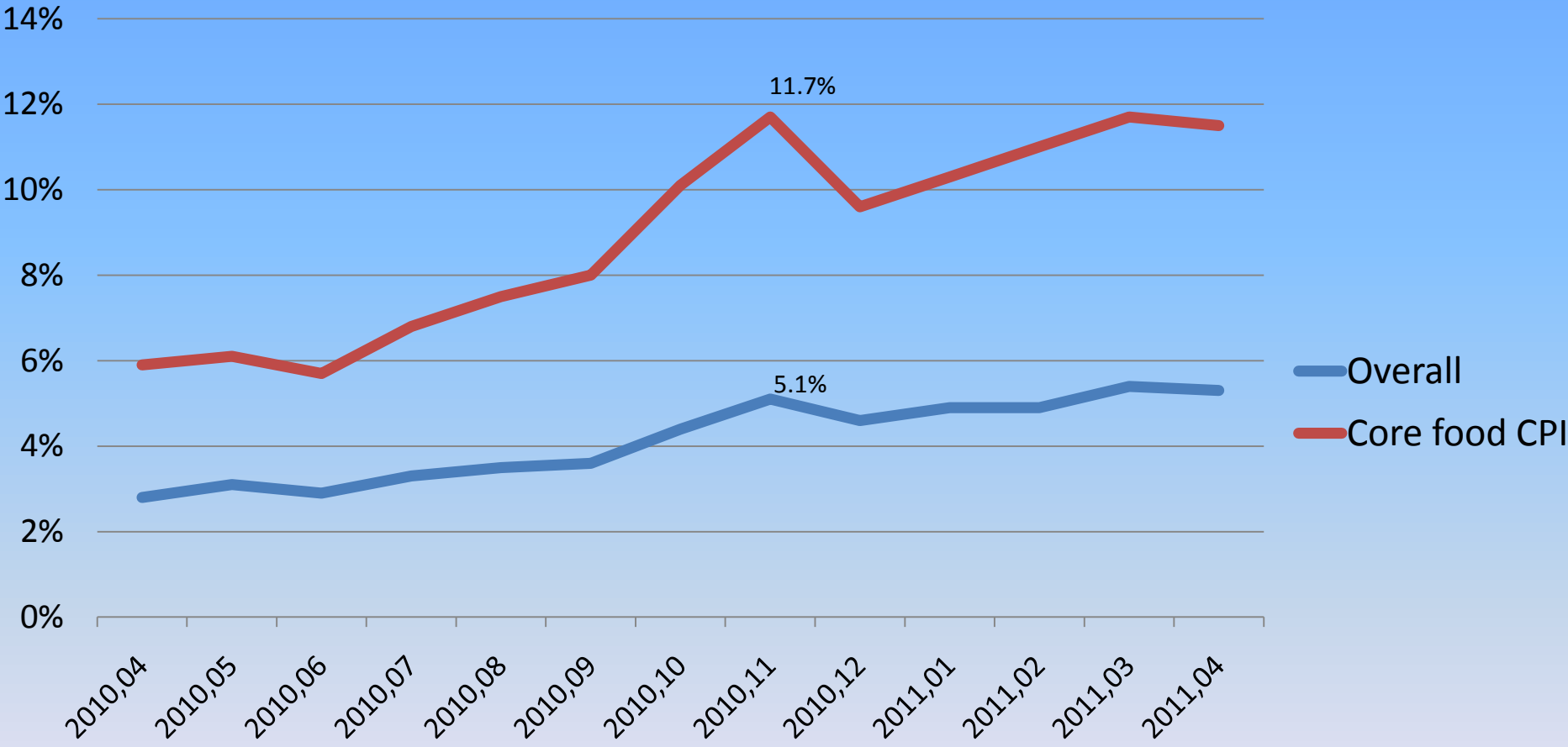
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Appendix



Consumer Price Index in China

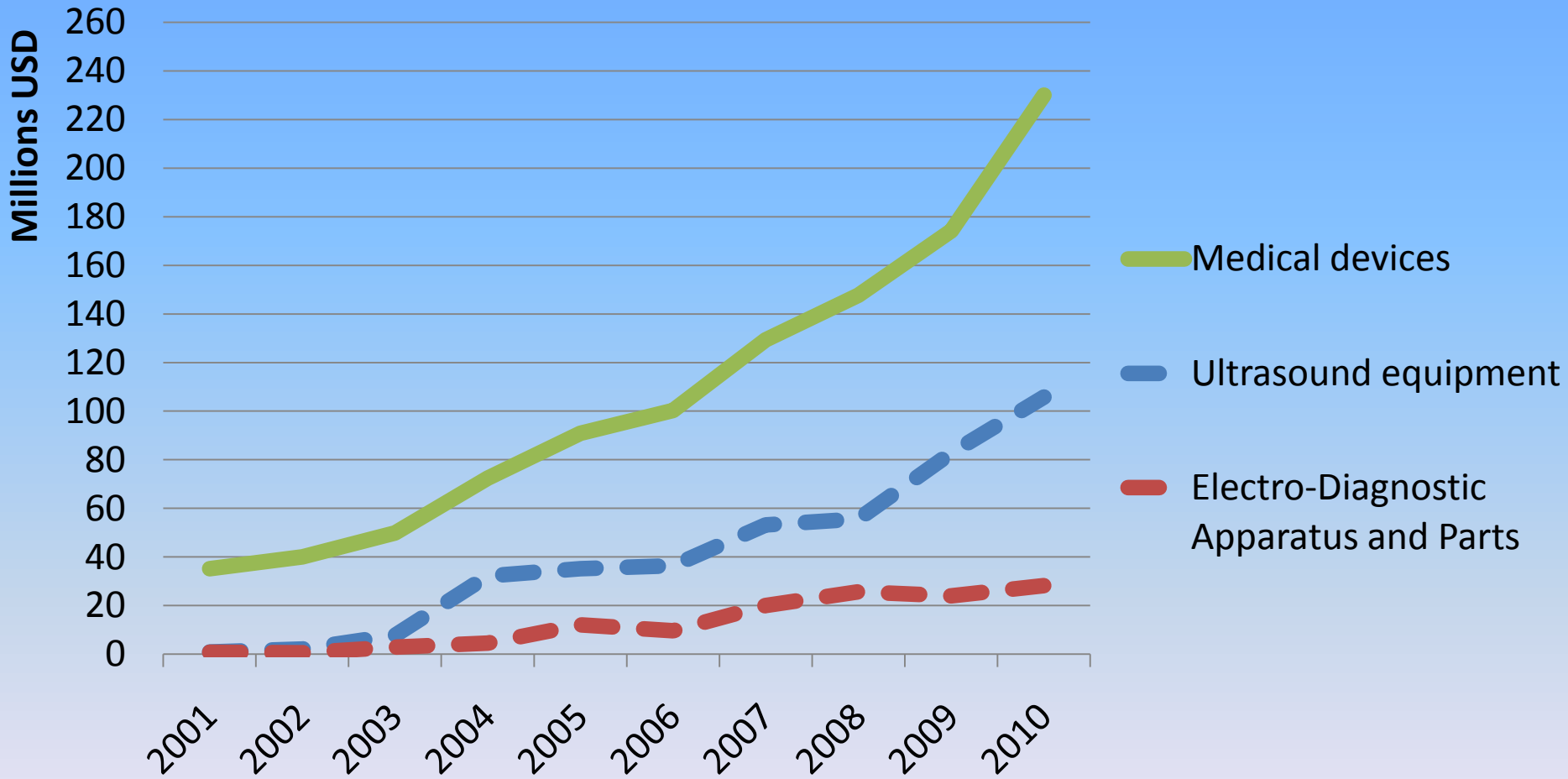
Year-over-year change, by month



Data source: National Bureau of Statistics, People's Republic of China

Washington's Medical Device Exports to China

Total exports, and two largest products



Return to presentation

Data source: WISER Trade



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