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The Political Economy of China's "New Normal"

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Visions of the "New Normal"

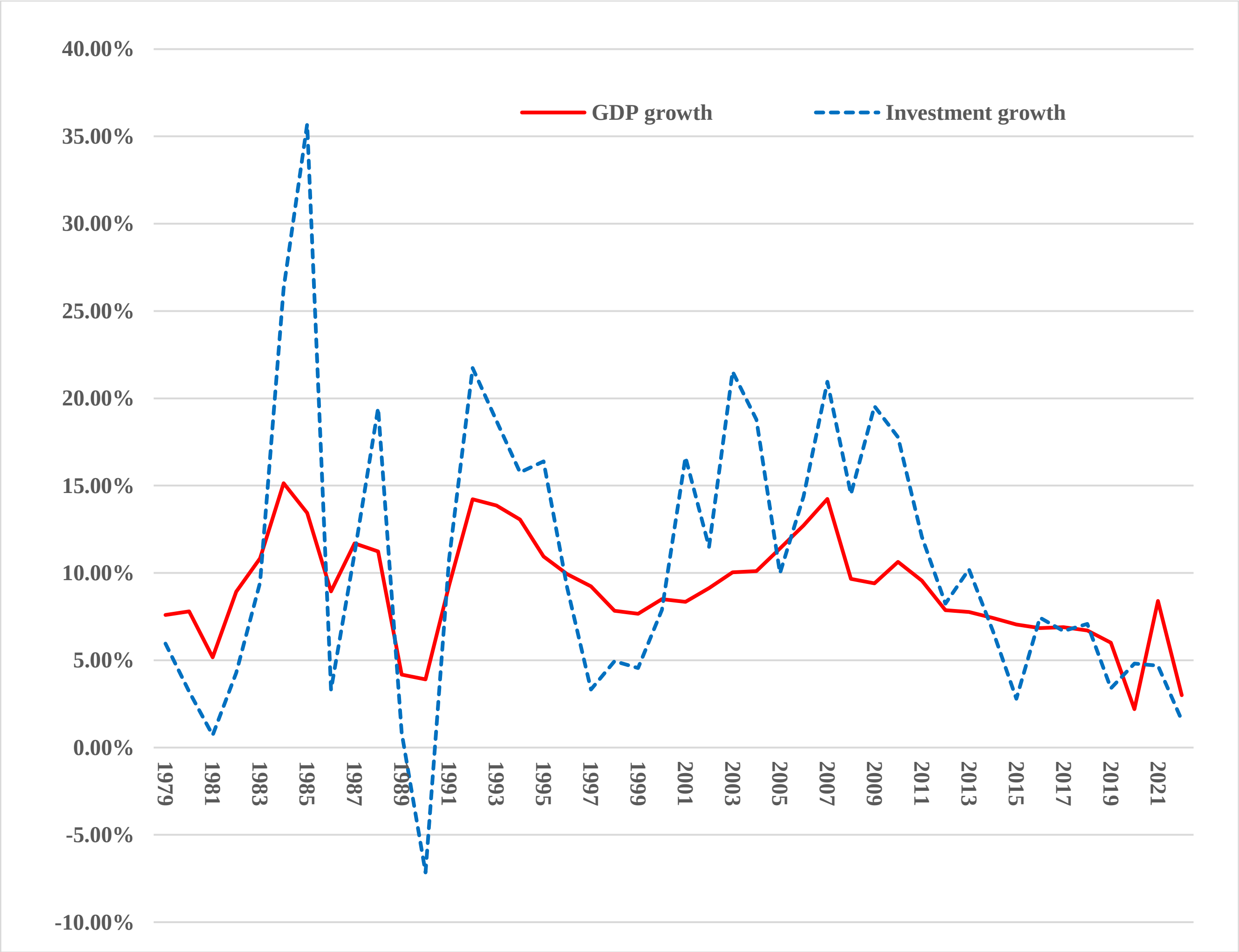
- Slow-down in economic growth is the upmost among the defining characteristics of China's "New Normal", post-2012.

- Ostensibly, the immediate cause is investment stagnation, esp. non-state investment, noting that investment is a source of current demand and a capacity of future supply (Figure 1 & 2).

- What are the basic causes? And what are the underlying structural-institutional conditions? Ultimately, what direction for Chinese economic transformation – in order to sustain medium-speed growth, or even to resume high-speed growth?

- Existing interpretations of the growth slowdown have coalesced around two theses: namely, demand deficiency and profitability decline.

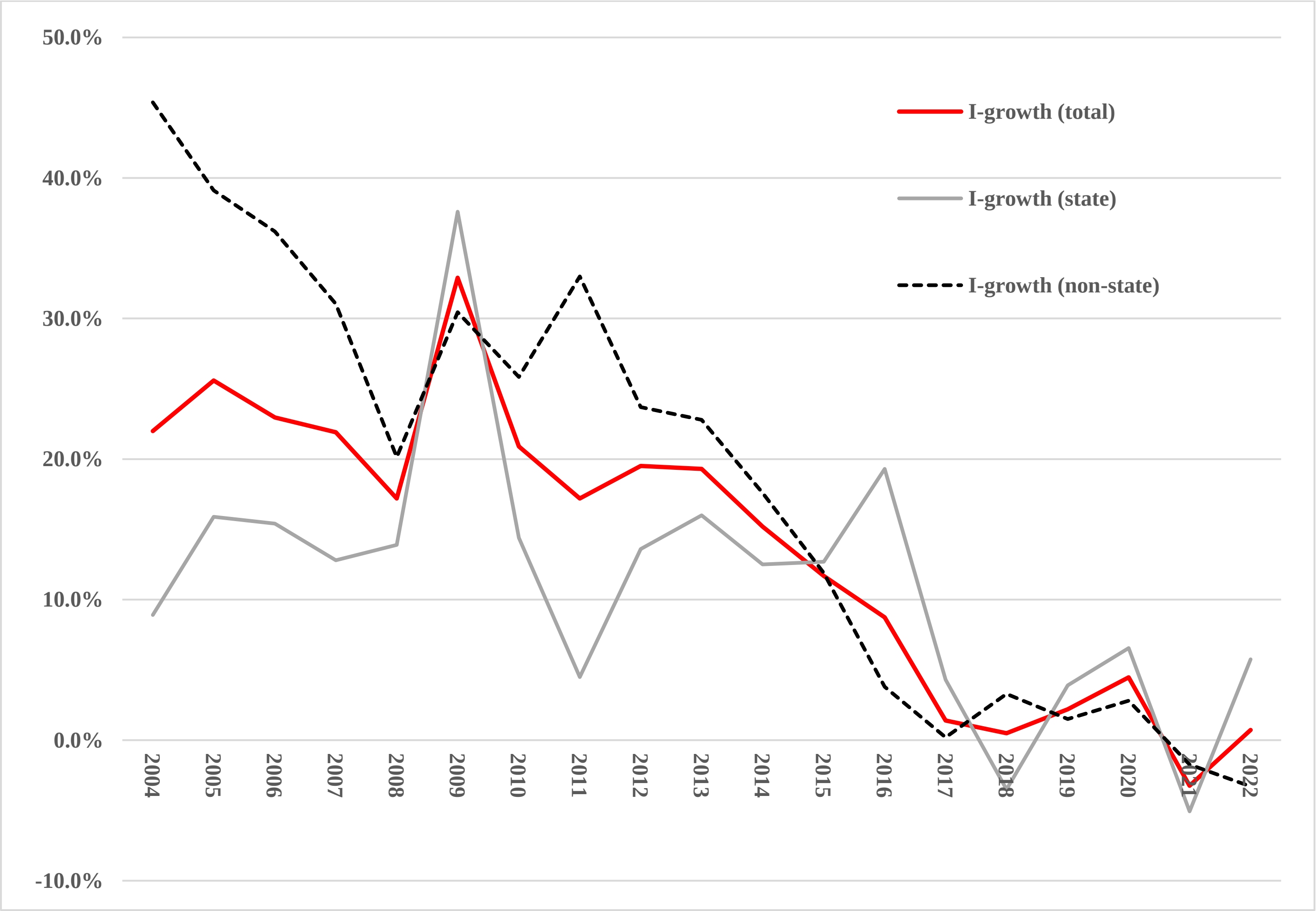
Figure 1. Real growth rate of GDP and investment



Sources: Chinese National Bureau of Statistics, National Statistics, accessed 15th August 2023.

Notes: Investment refers to gross capital formation. Its growth rates are computed by using as deflator the investment price index until 2019, and the producer price index after 2019.

Figure 2. Real annual growth rates of investment (%)



Sources: Chinese National Bureau of Statistics, *National Statistics*, accessed 26th March 2023.

Notes: Investment refers to total fixed-asset investment. Its growth rates are computed by using the investment price index as deflator.

Demand Deficiency

- Alternative views on the causes of investment stagnation: demand deficiency and profitability decline (Figure 3).

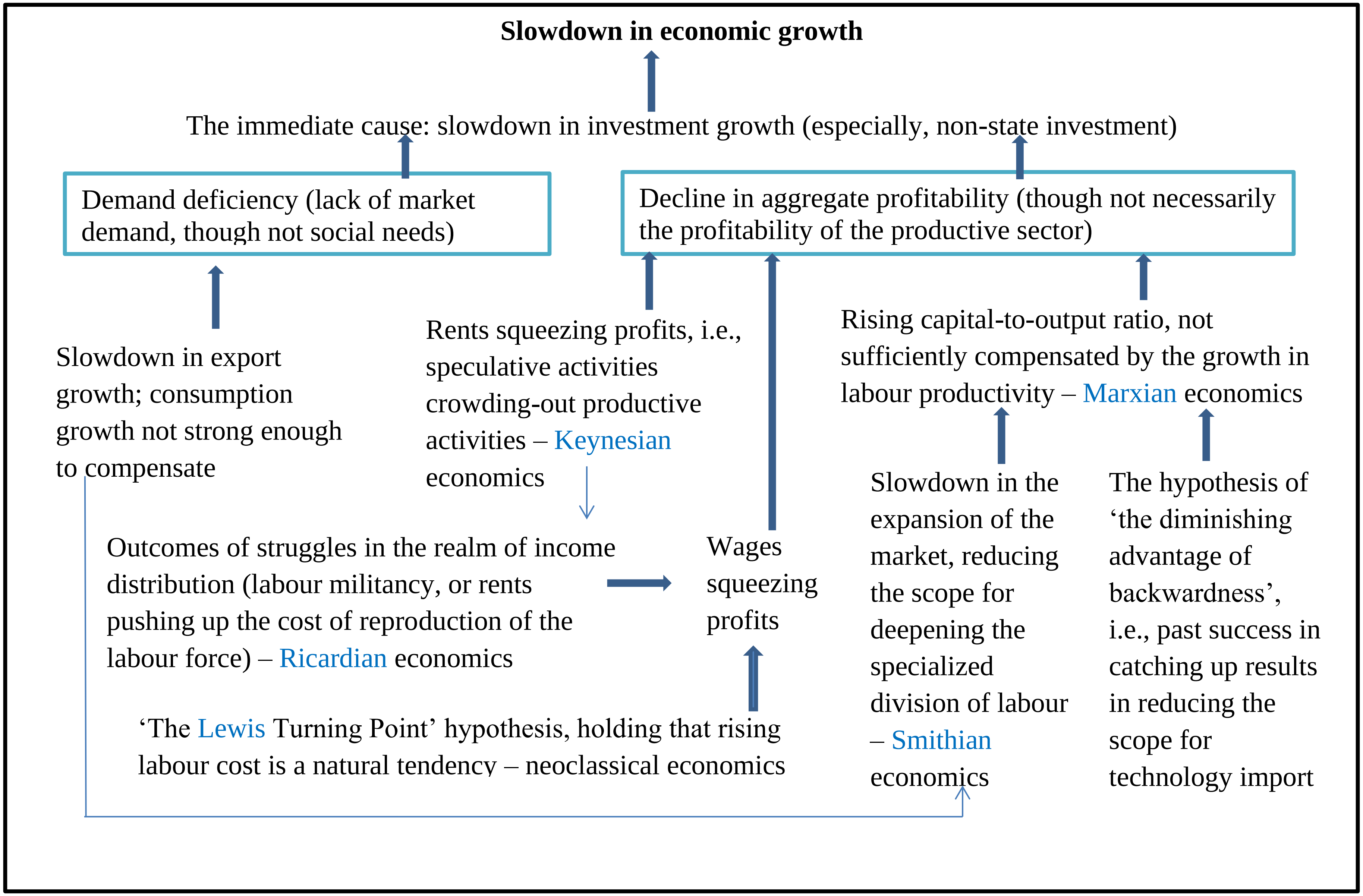
- Demand deficiency: excess capacity, trade friction… factories closure and inventories piling up, esp. blocks of unoccupied or semi-completed residential properties.

- The thesis of imbalances in the composition of aggregate demand – and that of the “global savings glut” (“trade wars are class wars”…).

- Under-consumption reflects uneven income distribution, and “ghost towns” reflects market demands vs. social needs, both – together with the predominance of non-state investment – indicating the prevalence of market relations in the economy.

- Hence the policy objectives of rebalancing and restructuring.

Figure 3. Alternative explanations of the slowdown of Chinese economic growth



Profitability Decline

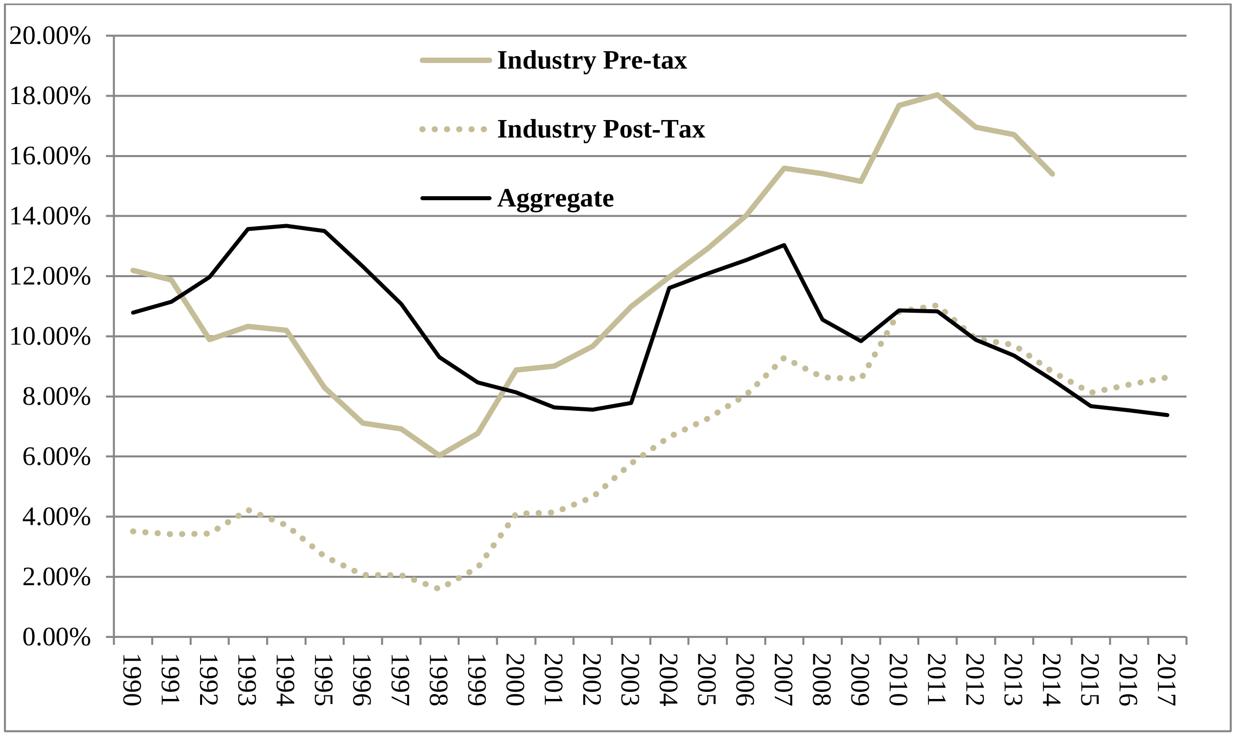
- Three main explanations of the decline in aggregate profitability: rents squeezing profits, wages squeezing profits, and the rise in capital-to-output ratio undermining profitability.

- But is profitability decline true? For aggregate profitability, most estimates find that there is indeed a trend of secular decline – starting from circa 2005 and worsening post-2008. But note that this is not true for industrial profitability. Growth of industrial profits falls, but profit rates remain at high levels (Figure 4).

- What accounts for the divergence between industrial and aggregate profitability? Possible reason: speculation crowding-out production, i.e., the allocation of an increasingly bigger share of total capital to speculative sectors – a story of rents squeezing profits.

- Under the New Normal, financialization takes the form of the massive expansion and then the booms and busts of the real estate sector, and of the stock market (Figure 5).

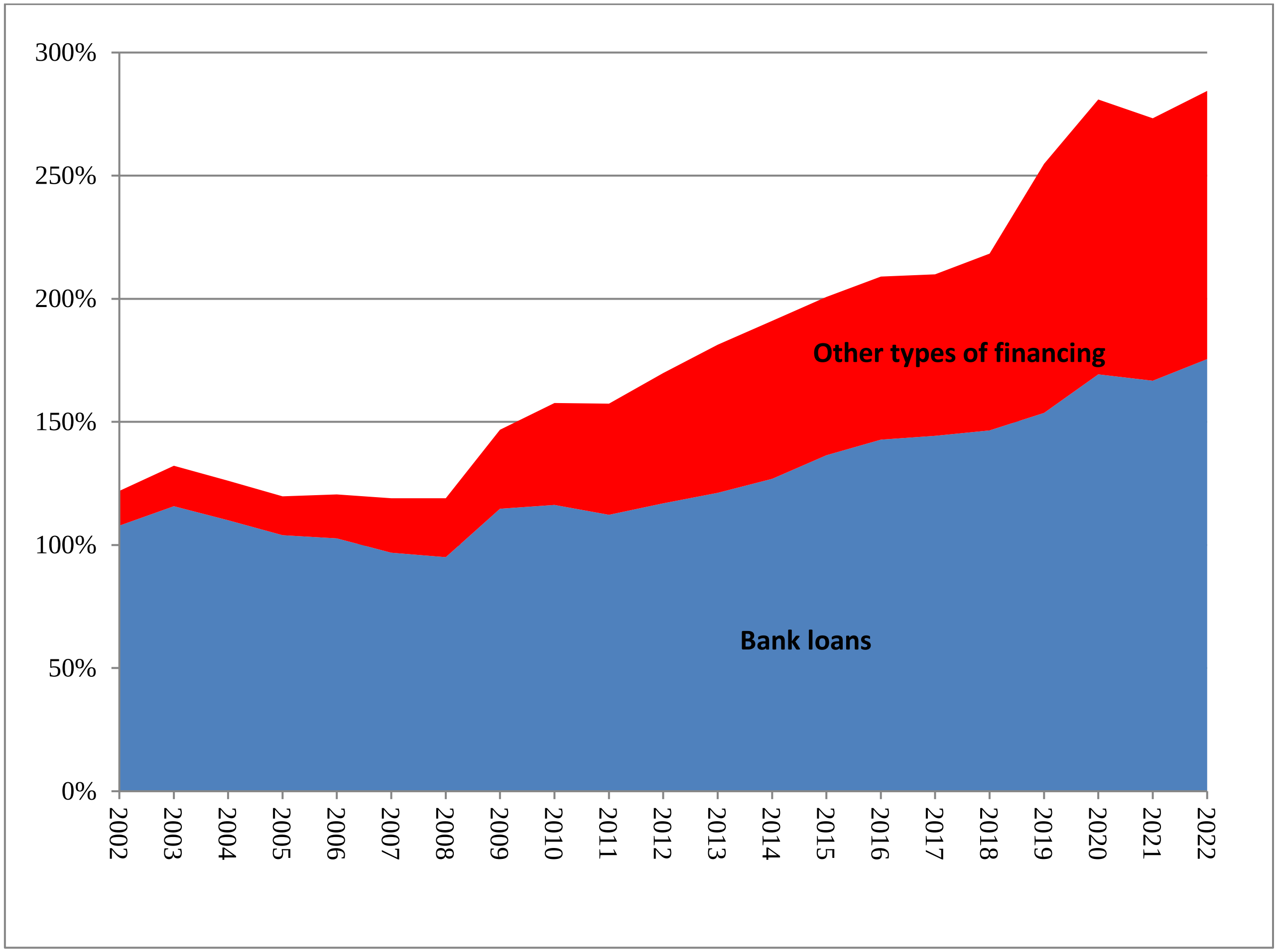
Figure 4. Aggregate and industrial profit rates (%)



Sources: Industrial profit rates are official, from Chinese National Bureau of Statistics, *China Statistical Yearbook* and *China Industrial Economics Statistical Yearbook*, various issues, and NBS data bank. Aggregate profit rates are estimates.

Notes: Pre-tax profit rate = (total taxes + total profits) / (working capital + net value of fixed assets). Industry = all township-and-above independently accounting industrial enterprises before 1998, and all state-owned enterprises plus above-scale non-state-owned enterprises after 1998. Aggregate profit rate = $(Y - L - T - D)/K$, where Y = GDP, L = labour income, T = tax on productive enterprises, D = depreciation, K = capital stock, and K is estimated from data of annual investment in fixed-assets since 1952.

Figure 5. Total Social Financing to the Real Economy (year-end stock, % of GDP)



Sources: People's Bank of China website, http://www.pbc.gov.cn/ accessed 4th September 2023.

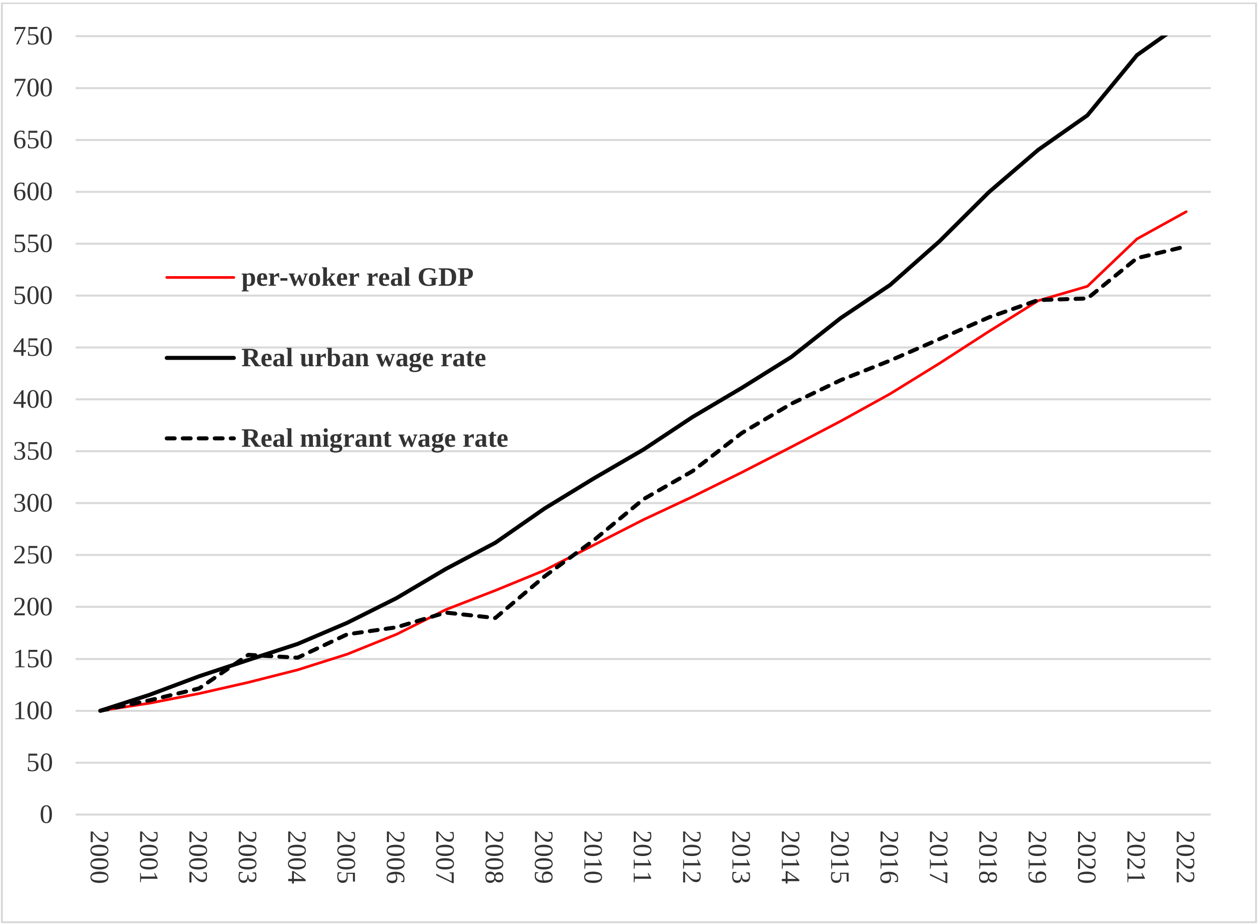
- Meanwhile, the story of wages squeezing profits, i.e., “cheap labour” no more, has its empirical backing in the form of fast wage growth since the turn of the century (Figure 6).

- This story is associated with three different theories:
  (1) the “Lewis Turning Point”;
  (2) labour militancy; and
  (3) wage growth masking rents rise.
  Of the three theories, (2) appears to be containing more elements of empirical truth.

- The story of the rise in capital-to-output ratio undermining profitability, for applying to China’s New Normal, is most consistent to Marxian theory. Conceptually, it could be caused by:
  (a) decreases in labour extraction;
  (b) demand deficiency; or
  (c) the exhaustion of the “advantages of backwardness”.
  It appears that (c) contains more elements of empirical truth.

- Overall, it appears that the causes of the investment stagnation, and hence growth slowdown, are complex and multifaceted. A systematic understanding, and policy responses, is needed.

Figure 6. Indices of per-worker real GDP and real wage rates



Sources: Per-worker GDP and urban wage rate data from *China Statistical Yearbook*, various issues; wage rate data for migrant workers from *Report on Monitoring and Surveying Migrant Workers*, various issues, and Lu Feng (2012) "Wage rate trends of China's migrant workers, 1979-2010', *Zhongguo Shehui Kexue* (Social Sciences in China), 2012, no.7: 47-67.

Reshaping the Model of Economic Transformation

- In the period 2000-2012, China experienced synchronous growth, all on unprecedented fast rates of investment and consumption, and of productivity and the wage rate. These provided the material conditions for broader social developments.

- Table 1: the unprecedented fast pace of growth in per-worker GDP (i.e., labour productivity) in 2000-2012, and the abrupt slowdown thereafter. This trend of evolution is similar to the growth in wage rates, already indicated in Figure 6.

- These trends of productivity and wage growth have been underpinned by investment growth, and accompanied by consumption growth. Table 2: the unprecedented fast growth in both investment and consumption in 2000-2012, and the abrupt slowdown thereafter.

- A balance seemed to be in existence between these two pairs of variables, thereby generating the good developmental outcomes in 2000-2012 (and the subsequent decline).

- This is similar to the experience of the Golden Age of the advanced countries in the period 1950-1973. Theoretically, the Golden Age Model can be characterized as having as its pillars the three agents of 'Big Business, Big Labour, and Big Government'.

Table 1. Average annual growth rate (%) of real GDP and employment

	(a) Real GDP	(b) Employment	(a)-(b)
1978-2000	9.7	2.1	**7.6**
2000-2012	10.2	0.5	**9.7**
2012-2022	6.2	-0.4	**6.6**

Sources: Chinese National Bureau of Statistics, *China Statistical Yearbook*, various years.

Table 2. Average annual real growth rates (%) of consumption and investment

	Consumption	Investment
1978-2000	8.2	9.2
2000-2012	10.3	15.0
2012-2022	6.8	5.5

Sources: Chinese National Bureau of Statistics, *China Statistical Yearbook*, various years.

Notes: Data are consumption and investment (i.e., gross capital formation) components of GDP by expenditures approach. Consumption growth is deflated by the consumer price index; investment growth is deflated by the investment price index.

- In the case of China, in the period 2000-2012, along with rapid investment growth was the famous phenomenon known as '*guo jin min tui*' (the state sector advances, whilst the private sector retreats). The state-owned enterprises (SOEs) are the Big Business in China.

- The formation of Big Labour is evident not only in the wage growth but also in institutional and policy moves such as minimum wage legislations, the enforcement of the Labour Law, the enactment of the Employment Contract Law, collective bargaining, unionization, etc.

- Big Government takes the form of the state orienting itself towards rebuilding a comprehensive (although still primitive) welfare system, as well as its active role in infrastructural investment and science and technology investment.

- The recurring disruptions to the path of convergence to the Golden Age Model under the New Normal could be attributed to the process of financialization of the economy.

- This can be gauged by observing the massive expansion in the stock of 'total social financing to the real economy' (TSF), indicated above in Figure 5: in the years 2003-2008, the ratio of TSF to GDP remained basically unchanged. Thereafter, it surged from 119% in the year-end of 2008 to reach 255% by the year-end of 2019 (and further to 284% by the year-end of 2022).

- Chinese banks, of which the biggest ones are all state banks, have traditionally been under tough government controls and regulations. The process of financial liberalization post-2008, however, has largely set them free in participating in speculative activities (shadow banking activities…).

Non-bank financing activities have been subject to even less government controls and regulations. The fact that both types of financing have expanded tremendously can only result in the precipitation of capital in speculative activities.

Concluding Remarks

- The cause of the slowdown in investment growth, and therefore economic growth, in China under the New Normal is complex and multi-faceted.

- Since the turn of the century, there has been a rivalry between two alternative directions for Chinese economic transformation: the convergence to the Golden Age Model versus the tendency of financialization.

- After the stock market crash in summer 2015 and the continuous worsening of economic performance, the Chinese state leadership has reoriented itself to turn to emphasise curtailing speculative activities and promoting productive activities.

- Whether this orientation can achieve the hoped-for outcome of medium-speed or high-speed economic growth, however, remains to be seen.