



## China's Economy: What Everyone Needs to Know

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In *China's Economy: What Everyone Needs to Know*, Arthur Kroeber examines the recent development and roles of key sectors in China's economy. He also discusses the hot issues of labour markets, consumer spending, and income inequality. His discussion addresses current problems and how the Government has reacted to them. The last two chapters emphasize the need for China to focus on more efficient growth and its growing impact on the world.

For the most part, the book is more descriptive than prescriptive. It provides a concise and well-guided tour of China's economy rather than intensively arguing a particular thesis. It is reader-friendly with plain language and simple graphs illustrating trends. Each chapter consists of short sections headed by questions, so readers can easily follow the main logic and avoid getting lost in the details. Despite his experience of living in China, the author bases his assessments more on statistics and public sources than on personal observations.

The author comprehensively examines China's industrial policy and export boom in Chapter 3. He attributes China's export boom to its historical advantage, "recent" luck, and appropriate policies. For example, China has a large population and commercial tradition. China opened up to trade just when long-distance shipping costs steeply fell and companies were building global production chains. Inspired by the earlier success of East-Asian nations, the Chinese Government carried out the economic program of "reform and opening" in the 1980s and built the infrastructure along the coastline to a world-class level. Since many people suspect that China's aggressive industrial policies created unfair advantages for Chinese firms, the author provides a detailed answer to the question of whether China engaged in an unfair competition. He points out that such claims are essentially political. Every industrialized country, including the United States, subsidizes politically important industries and manipulates prices especially when it play a catch-up with other economies. He cites related statistics and facts to argue that the cheap *yuan*, low interest rates, and regulated energy prices have played no more than a supporting role in China's industrial and export growth.

The comparison between China and industrialized countries is objective and informative, but readers do not learn from the book whether the trade deficit would have been a real problem for other countries even if China did produce exports at "unfairly" low costs. For the

United States, the trade deficit with China is a solution to maintaining its living standard under high government spending and low tax rates. As high Government spending could easily overheat the United States economy, in the absence of a trade deficit the central bank would have to raise interest rates and reduce investment to maintain non-inflationary full employment. Currently the trade deficit offsets part of the high consumption and Government purchases. If the trade deficit were smaller or did not exist, the United States macro-economic policy would need to reduce investment, consumption, or Government spending, all of which would lower the American living standard. A favorable terms of trade matters much more to a country than whether imports are “too cheap.” Like a private company, a country benefits from selling expensive exports and buying cheap imports.

Throughout the book the author stresses that China must change its growth model from resource mobilization to efficiency gains. In the past three decades China focused on mobilizing its vast resources of labour and capital to the needed industries. As China’s capital stock approaches the rich-country level, it should rely more on maximizing the output per unit of capital rather than simply throwing more capital into the economy. The author explains that the Government stimulus program after the 2008 financial crisis put excessive investment in the state-owned enterprises and accelerated the decline of the return on capital. The sharp drop of global demand in the 2008 crisis also demonstrated the vulnerability of export sectors and called for a more consumption-driven economy. The Third Plenum of the Eighteenth Party Congress in 2013 released new policies

to enhance the efficiency of the economy. The Government will gradually let the market play a decisive role in resource allocation, but it will continue supporting the dominant role of the state sector. The author points out an apparent conflict between the goals of a free market and a dominant state, since the market outlined in the policy does not allow transferring the control of resources from the state to the private sector. He argues that the private sector has been and will still be the major source of productivity gains in China’s economy.

The author does not mention the latest set of “supply-side structural reforms” announced after the Fifth Plenum in October 2015. The supply-side reforms, first proposed by President Xi in an internal meeting, mark significant progress. As Chinese economic growth slows and demand-side policies run up against supply-side constraints, the government aims to adjust the severe mismatch between demand and supply in the China’s regulated economy. At present the state-owned enterprises, especially the ones in the steel and coal industries, provide excessive supply, but many consumers rush to buy foreign products of higher quality than their domestic counterparts. According to the new book *China’s Supply-side Structural Reforms* by the Chinese Academy of Governance (2016), the government plans to eliminate the excessive investment and expand the social insurance for the laid-off workers. The supply-side reforms are also aimed at reducing the labour, property, and finance costs for companies in general. For example, although China’s physical capital has been growing fast, China’s human capital still lags behind the need for it. The reforms will further alleviate poverty in rural areas and build a modern sys-

tem of technical education.

The author introduces the banking system and the government's "financial repression" policies in Chapter 7. An important issue that the author does not elaborate on is the underdeveloped capital market plagued by the government intervention and drastic volatility. In 2015, for example, the Shanghai Composite Index skyrocketed from 3000 to 5100 points and then plunged back to below 3000 points. Under huge pressure the Government ordered a "national team" of state-owned security companies to buy shares and combat the falling stock prices. Since retail investors account for about 80% of the trading volume, the price volatility has caused widespread panic and uncertainty (Rabinovitch, 2016). A related problem is that ordinary people in China have limited investment options as the deposit interest rates barely keep up with inflation and mutual funds have high expenses (Wang and Tower, 2016). Many people seeking higher returns on their savings speculate in shadow lending and the property market, which are difficult for the Government to regulate.

The author uses a moderate approach to discuss the sensitive issues of China's income inequality, political reforms, and global influence. The income inequality in China has significantly increased since the late 1970s and the Gini index is now close to 0.5. While some Chinese are worried about the possibility of social unrest, the author shows that the income inequality may have peaked as poorer people see their income growing faster than rich ones. The average income has increased rapidly from a low starting point, so most people seem satisfied with their personal gains. Based on recent examples of East-Asian and

Eastern European nations, many people also predict that political transitions to a democratic society will be inevitable as China moves towards a market economy. The author disagrees and lists several reasons why President Xi's "Leninist Capitalism" will likely succeed. Besides the acquiescence of most citizens, he mentions that the Government has made effective efforts to address discontents and improve its own governance. Some people from developed countries are concerned that China will replace the existing world order led by the United States, but the author points out that China has limited political impacts outside its immediate neighborhood in Asia and its institutions lack the intellectual resources to change the basic rules for the global economy. Although the current Government is now more assertive in the South China Sea and actively building its own multilateral institutions like the Asian Infrastructure Investment Bank, China maintains the principle of noninterference in internal policies of other nations and is unlikely to become "as activist as" the United States (one wonders, though, if the author would have made the same conclusions if he had known the 2016 Presidential election results in the United States).

As a foreigner, the author recognizes that China's economy is complex and deeply rooted in its own traditions. He begins the book by reviewing China's unique political system that is "formally centralized, but in practice highly decentralized." Despite the powerful central Government, local governments enjoy considerable autonomy in allocating fiscal budgets and executing central orders. In response to the fear of China's repressive politics, the author suggests that the United States should

acknowledge the distinct system of Chinese values. Over its long and resilient history China's bureaucracy has placed more emphasis on effective governance than democratic elections, although such a governance system has flaws and will continue to evolve as China integrates with the rest of the world. China's recent officials have not blindly followed particular theories but pushed the reforms based on domestic reality. In summarizing China's development, the author paraphrases from the economist Justin Lin and writes that "the most important lesson other developing countries can glean from China's experience is the value of pragmatism."

The book engages readers in a deep and comprehensive discussion of China's economy. It helps readers understand China's recent growth and mounting challenges by relating economic theories to its unique economic and political conditions. General readers can quickly become familiar with the key issues while experts may find it a handy summary. The book is a rewarding and refreshing piece for everyone interested in China's economy.

## References

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