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## **EXPORT-ORIENTED ECONOMY IN CHINA**

Lead-in: Since 1978, China has pursued a policy of reform and opening to the outside world, a policy which was initiated by Deng Xiaoping. Major efforts have been made to readjust the economic structure, and reform the economic .China's economy has increased rapidly with export-oriented economy strategy from that time. Thirty years has passed, this rapid economic growth also created problems, such like serious structural imbalances, slow growth of residential income and domestic consumption, and heavy reliance on investment and so on.

China's export-oriented growth is rooted in a double transition of structural change and demographic transition. Accession to the WTO has allowed China to fully integrate into the world system and capture the gains of its comparative advantage in abundant labour supply.

The double transition will take maybe 10 to 15 years to finish. Over this transition, China is likely to continue its fast export-oriented growth. Along the way, export-oriented growth has also created serious structural imbalances highlighted by underutilised savings, slow growth of residential income and domestic consumption, and heavy reliance on investment. This linkage requires new thinking about the way in which global imbalances need to be tackled.

China has managed nearly double-digit growth rates since it began economic reform and opening in 1978. The reform has transformed the Chinese economy from a planned economy to a mixed economy where the market plays a dominant role in resource allocation. Much of China's remarkable growth between 1978 and 2000 can be explained by the reform. But the more recent and faster growth in the last decade has been mainly driven by exports.

Joining the WTO in 2001 was a turning point in China's integration into the world system and allowed China to capitalise fully on its large supply of labour induced by the 'double transition,' namely, drastic demographic transition and a fast pace of industrialisation. Using the growth trajectory of other East Asian economies as a reference, China can be expected to sustain fast economic growth for the next 10 to 15 years before its growth rate converges to its long-run steady state.

Export-oriented growth has also created structural problems that have to be addressed to achieve more balanced growth. The most important problems are high savings and persistent current account surpluses. At a low income level, China has been forced to export its savings to much richer countries. Related to this problem is the slow growth of domestic consumption and the declining share of consumption in GDP. This can be mostly attributed to the slower growth of household income relative to the growth of GDP. The other side of the story is faster growth of corporate income and government revenue. Enterprises have reinvested most of their profits and the government has spent a large proportion of its revenue on capital formation. The result is that China is still an investment-driven economy.

The fundamental cause of these imbalance problems can be traced to China's double transition. The double transition refers to two profound transformations happening in China. One is its fast pace of industrialisation and the accompanying rural-urban migration, and the other is the extraordinary demographic transition since China implemented the one-child policy in 1979. The double transition has shaped China's extraordinary growth model, especially after China fully integrated into the world system through accession to the WTO. The double transition has given China vast comparative advantage in labour resources, and the accession to the WTO has allowed China to play this advantage to the full.

Because of the double transition, wage rates are suppressed and the benefits coming from the growth of trade have mostly accrued in the form of returns to capital and to government taxes. As a result, the share of labour income has declined, and this in turn has caused the share of consumption in GDP to decline. The other side of the coin is the increasing share of national savings in GDP. Because of the diminishing marginal return to capital, the growth of investment cannot catch up with the growth of savings, so the current account surplus has increased.

The sustainability of China's export-oriented growth depends on the pace of China's double transition. Two issues will determine the outlook for China's long-term economic growth. One is when China will use up its demographic dividend, and the other is whether China has passed the so-called Lewis turning point.

Export-oriented growth has brought serious structural imbalance problems to China while sustaining a high rate of overall economic growth. China's imbalance problems have their roots in China's double transition and, on this account, will only gradually ease as China completes its double transition in the next 15 to 20 years. This is a relatively long period of time. In the meantime, the imbalance problems may lead to serious social and political unrest that may disrupt China's growth trajectory.

While other factors (such as the exchange rate, distortion of factor prices, a weak financial sector, and an investment-oriented government) also contribute to China's imbalance problems, the double transition is its most fundamental cause. The double transition is an inevitable process and helps explain China's fast economic growth. And it requires new ways of thinking in dealing with China's and, for that matter, the world's imbalance problems.

**Conclusions:** Focusing on nominal parameters such as the exchange rate will not solve the imbalance problems. Structural adjustment should not be directed to eliminating imbalances, but should be geared toward how to utilize the savings created by the surplus countries. China's savings are created by its double transition. Other emerging countries, notably India, will also emerge as exporters of savings even if savings from China dry up when it finishes the double transition.

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