

Just let China grow

Many take as fact that the current pattern of global imbalances — large and persistent trade deficits and surpluses across different parts of the world, eventually unsustainable — is due to China and the rest of East Asia consuming too little and saving too much.

Since the global economy is a closed trading system, trade deficits and surpluses across all national economies must sum exactly to zero always. Therefore, that one part of the world saves too much and thereby runs trade surpluses means other parts of the world, notably the US, must be running trade deficits.

However, just because deficits and surpluses are tightly interconnected does not mean that trade surpluses in China, say, have been responsible for US trade deficits; absent further information, causality could well have flowed in the opposite direction.

Moreover, China's high savings might be dynamically welfare-optimising for its citizens. For instance, private enterprise in China might find self-accumulation the only way to generate investment funds. Finally, it might be that global imbalances should best be viewed not as a bilateral (US-China) problem but as a multilateral one instead.

Be that as it may, many US policy-makers focusing on US trade deficits and China's trade surpluses urge policy actions against China to rebalance the global economy. Those policy actions include punitive tariffs against Chinese imports and tagging China as a currency-manipulator, thus moving it yet further away from official free-market status.

Some observers — including Michael Pettis, Nouriel Roubini and Martin Wolf — remark that, without such external pressure, China will find it domestically too difficult to shift away from its reliance on export promotion, infrastructure investment, and restrained consumption towards a more balanced growth path.

Let us summarise the situation. The problem: to raise China's domestic aggregate demand, especially consumption. The difficulty: China's consumption cannot increase quickly enough to compensate for the shortfall in aggregate demand, should both investment and exports

decline. The danger: a hard landing for China and the global economy.

I want to suggest that such a re-direction need not be that difficult. My proposal: Let China grow rich as quickly as possible. Why might this do the trick?

First, consumption within China

is already rising faster than both income and investment, provided that we look at those parts of China where incomes per head exceed US\$8,800 (RM27,700) (see Figure 1). Of course, China's current per capita income overall now is only US\$2,200, less than 6% that of the US. What this suggests, however, is as China's income grows, its overall savings rate will naturally fall. The right policy is to encourage growth, not adopt punitive actions that might retard that growth.

Second, as British academic John Ross reminds us, investment too is aggregate demand. But, third, continuing to increase China's investment in, among other things, infrastructure and transportation can help further, as it allows those western, poorer regions in China better to integrate both nationally and globally, and thus become richer through raising demand and productivity.

While many observers make much of China's high investment-to-income ratio, it is useful to note that that ratio is high not just because its nu-



MY Say

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merator is being driven up, but also because the denominator remains so low. The right state variable for dynamic analysis in a neoclassical growth model is capital per head, not capital per unit of income (see Figure 2).

However much anyone might doubt these China statistics, auxiliary evidence shows that rich Chinese consumers have no difficulty increasing consumption. In London, sales on Boxing Day last year were dominated by Chinese customers spending on average more than £1,310 (RM6,369) each.

The evidence I have described doesn't, of course, say that global imbalances can be easily erased through just more economic growth in China. However, the algebraic signs of the required relations seem to me to point at least in the right direction.

Careful work to quantify these effects might end up showing that their magnitudes aren't large enough. But, as far as I know, that calibration has not been done, which makes me wonder why some observers can be so certain that China's current growth trajectory can only exacerbate global imbalances.

When China becomes rich, that will also dramatically lower inequality in the world — globally, the difference in incomes per head across nations overwhelms that across individuals within a single country. No one I know arguing for a more egalitarian society also says that that push for equality should stop at their nation's borders and be kept from applying seamlessly across humanity's population of seven billion. ■

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Figure 1: Regional incomes in China

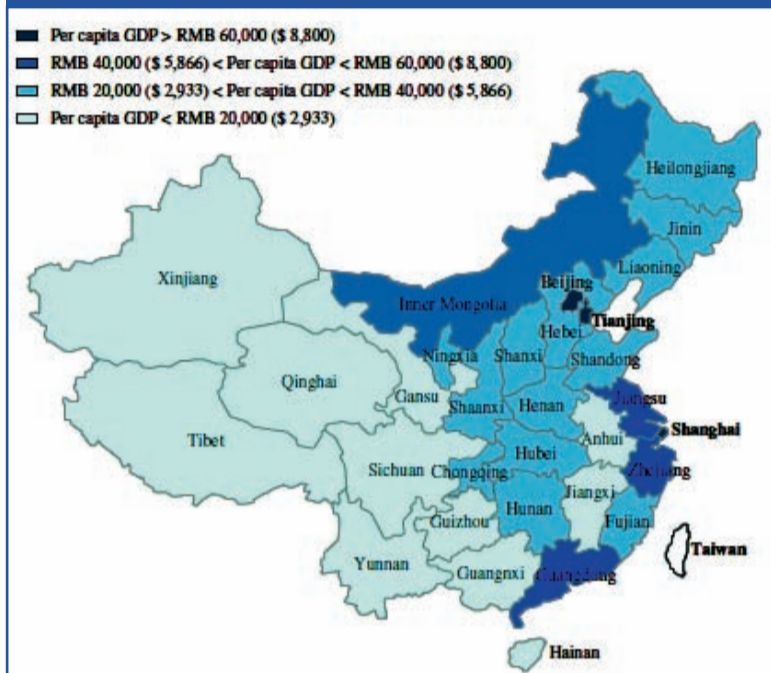
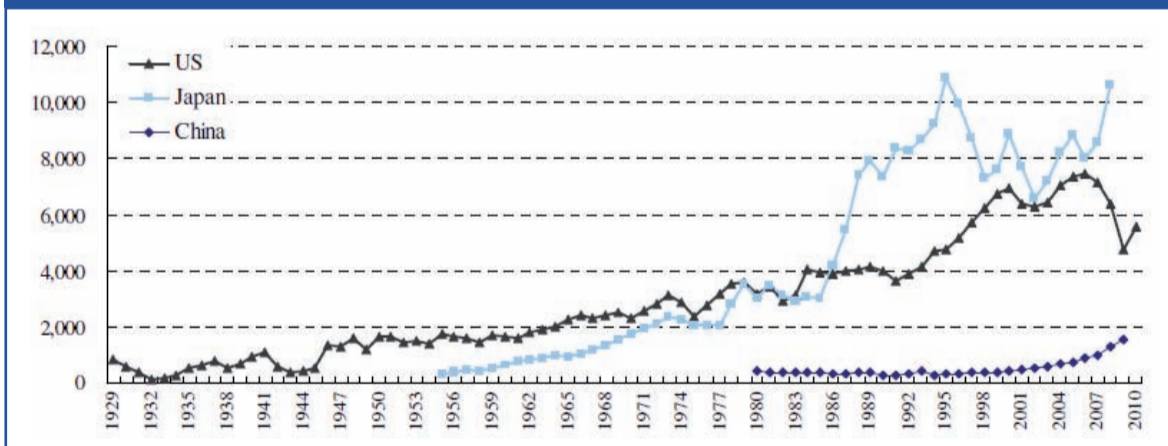


Figure 2: China's per capita investment



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