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On

"In-Depth Analysis – Chinese Economy: On the Sources and Mechanism of Economic Growth in China"

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This report serves as documentary record of the third seminar hosted by the Institute for International Monetary Affairs (IIMA) on February 24, 2017, in its Chinese economic series for this year. The title of the seminar was "In-Depth Analysis – Chinese Economy: On the Sources and Mechanisms of Economic Growth in China". The lecturer was Dr. Ligang Song from the Australian National University.

Welcome Remarks

Mr. Muneo Kurauchi, Managing Director of IIMA

Mr. Koji Sakuma, General Manager and Chief Economist of IIMA

Mr. Muneo Kurauchi welcomed the guest speaker Dr. Song and all the attendees and expressed his thanks to all of their continuing support for the IIMA. He said the IIMA organized this as the third event of a seminar series focusing on China in this 2016 fiscal year. Following him, Mr. Koji Sakuma briefly introduced Dr. Song's profile and experiences as a scholar and a consultant.

Seminar

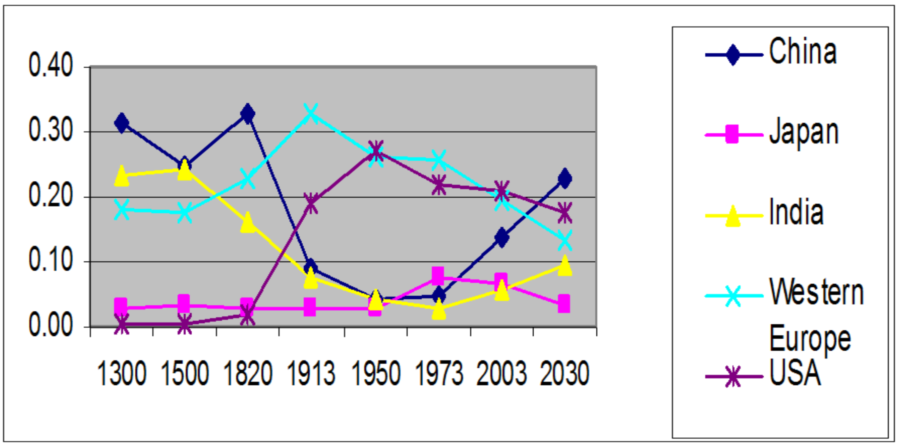
Dr. Song Ligang, Associate Professor in Crawford School of Public Policy, Director of China Economy Program at the Australian National University

Dr. Song first thanked the IIMA for the invitation to the seminar and introduction by Mr. Kurauchi and Mr. Sakuma. He said that in order to understand economic growth of China, it is necessary to understand history, theory, policy and environment, and that he would draw the relationship between the sources and mechanism of growth in the presentation.

1. The rapid growth of Chinese economy: Views from historical perspective

(1) Maddison's study

Dr. Song explained the world history based on Angus Maddison's famous study. The chart below shows historical changes of global GDP share of major economies from 1300s until forecasted 2030s.



Before the 18th or 19th centuries, China had occupied about one-third of the global economy. However, after the industrial revolution, a big change happened in Western Europe, which was called the big convergence. It resulted in a big diversion between Asia and Western Europe. China and India begun to lose their shares in the global economy comparing to the new powers: Western Europe, and later on the North America after the second half of the 19th century. The Great Britain surpassed China and became the largest manufacturing powerhouse in the 1870s. After that, China's ratio to the global GDP took a free fall. In most of the 20th century, until the end of China's Cultural Revolution and central planning economy, China only took 4-5% of the global GDP, compared with more than 30% of the global GDP in the 17th or 18th centuries.

The turning point for China was the reform in 1978 when it started preparation for taking off. India also was coming up. This is again called the big convergence in East Asia. Europe, despite the formation of the European Union (EU), would not hold its falling trend in the global economy. The United States peaked out immediately after the World War II and the falling trend is continuing. Japan rose quite dramatically in its post-war period, but peaked out in the 1980s, and then coming down. India still has the potential to catch up. It is predictable that China may become the largest economy in the world once again in around 20 or 30 years from now on.

To understand rising China in such a historical trend is interesting, Dr. Song said, adding that the International Monetary Fund (IMF) already announced that China had become the largest economy in the world on purchasing power parities (PPP) terms in 2014. He said we knew National accounts of China are at 11 trillion US dollars, as compared with 17 trillion US dollars of the U.S. which is still much bigger than China's. In terms of relative growth, however, the convergence is going to continue for the next stage.

(2) Quadrupling living standards from a base of $2,000 per capita GDP

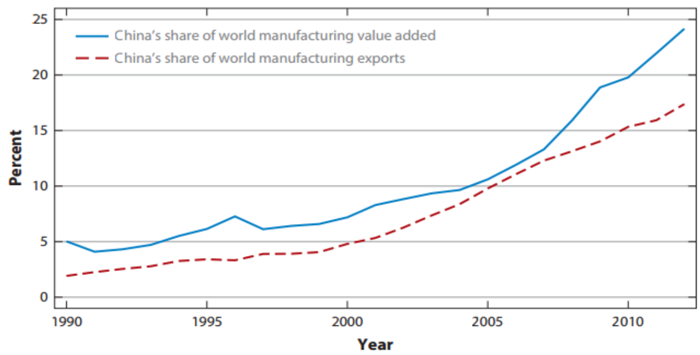
Dr. Song explained the chart below which was made by his research team.

Modern country	Year achieved $2,000 GDP per head	Year achieved $8,000 GDP per head	Number of years to quadruple GDP per head	Compound annual growth rate in period
Netherlands	1827	1960	133	1.0
United Kingdom	1839	1957	118	1.2
Australia	1848	1955	107	1.3
United States	1860	1941	81	1.7
France	1869	1962	93	1.5
Germany	1874	1962	88	1.6
Mexico	1950	2008	58	2.4
Hong Kong	1950	1977	27	5.3
Singapore	1950	1979	29	4.9
Japan	1951	1968	17	8.5
Turkey	1955	2007	52	2.7
Taiwan	1965	1985	20	7.2
South Korea	1969	1989	20	7.2
Malaysia	1969	2002	33	4.3
Thailand	1976	2005	29	4.9
China	1995	2011	16	9.1
memo item				
World	1950	2004	54	2.6

It compares the years among countries (or regions), in which GDP per capita in PPP grew from a basis of $2,000 to $8,000; that means quadrupling. For most of the industrialized countries, it took more than 100 years. For example, Australia took 107 years, Netherlands 133 years, and the United States 81 years. In contrast, Japan took only about 17 years. Furthermore, China took only 16 years, and this never happened in the history. He pointed out that there were certain patterns: Late comers always catch up more quickly than old ones. Japan took the opportunities, drew up their plan, and developed fast in the post WW II period. Japan achieved an average annual growth rate of 5% throughout the period. China did it by 7.1%, and this record is very difficult to be broken.

(3) China’s share of world manufacturing valued added and manufacturing exports

Dr. Song said that China's share of world manufacturing value added and its share of world manufacturing exports have kept increasing. It reflects that China is the world factory.



Of course, he added, there are many issues associated with Chinese growth. What is going on in China now highlights some deep-rooted problems in its system, so we can raise questions: whether the trajectory of rapid growth will continue or not, and in what condition China can achieve such trajectory, and whether there is a big risk for China's economy to take a downturn. He answered these questions in his presentation.

2. Frameworks to analyze the rapid growth of the Chinese economy

Dr. Song explained that there are at least three theoretical frameworks in analyzing the growth performance in the past.

(1) Reforms

Reforms can deliver certain things: those are economic incentives. There are several factors in marketization, including decentralization, privatization, industrialization, liberalization, globalization, and urbanization. The marketization gives huge incentives to the central and local governments, as well as to the enterprises. Among them, the local governments had the strongest incentives, which led the enormous economic growth.

(2) Supply- and demand- side analysis

The supply side has three factors: labor, capital, and total factor productivity (TFP), and the demand side also has three factors: investment, consumption, and net export. These frameworks well illustrate what happened to China in the past 30 years, and what is happening now, as well as what will happen in the future. Dr. Song elaborated on the supply side:

(a) Labor

In China's early phase of development, the economy was still enjoying the so-called demographic dividend. That meant the working age population's share was relatively high through the period. Things changed since 2004. The aging started: the Lewis turning point arrived. After that, the labor force became scarce and China has encountered the problems of labor shortage, and wages increased rapidly. The problem was not only in numbers but also in terms of quality of labors.

(b) Capital

At the beginning of reform, China was always in the shortage of capital. So, China was very urgent to try to generate surplus in trade to accumulate reserves. Money also came in through FDI, which increased rapidly and fulfilled the capital need.

There was a huge gap between savings and investment in meeting those demands of capital investment. The tricky thing is here. When you have a very high labor force or labor supply, it does not matter how much capital you added into the system. The capital is not subject to diminishing return, because there is so much labor. However, things will change later on. When there is not enough labor, then capital will be subject to diminishing return. But in China, with the huge supply of labor, the capital had actually increasing return.

(c) Total factor productivity (TFP)

The TFP highly contributed to the growth in the early and middle phase of reform, contributing almost 30 percent of the total growth, but no longer. The TFP improvement has come to a halt, decreased to almost zero. Capital return or efficiency of utilizing the capital, which used to be very high, is also suffered now. ,

Basically from the supply side, we illustrated labor, capital, TFP to underpin that high growth. (Analysis from the demand side is shown afterwards.)

(3) The globalization along with the domestic development

Adam Smith emphasized an important dimension; that is the division of labor and specialization. The specialization is associated with the size of the market. When the market changes from a closed economy to an open economy, the size of the market changes. It allows the market to enlarge in its both depth and width of specialization. China tremendously enjoyed the advantage of them since the 1980s when the economic reforms were delivered into China in a very dramatic way.

The 1980s and 1990s were the golden age of globalization. In the middle of the 1990s, the General Agreement on Tariffs and Trade (GATT) changed to the World Trade Organization (WTO), a multinational institution. The domestic development happened along with this globalization. In the open environment, China experienced a big domestic trend of migration that made three hundred million rural workers converted to urban workers of the industrial sectors. The duo of the globalization trend and the domestic trend happened at the same time.

The combination of these two is rare, or we have never seen this happened in the modern history. Japan did, but not on this scale in terms of the migration when it was integrated with the global economy. In the golden age of the globalization, the barrier of trade continued to get lower, and the export of China was benefited from it, but such a rare environment continued only in a very short period, for 15-20 years. Now, it no longer continues. De-globalization is happening. China was lucky because it caught up that time and could enjoy the efficiency of the scale.

3. Analyzing Chinese economy at the turning point

Dr. Song analyzed and explained issues on Chinese economy facing a turning point. He said that China's economic growth rate had fallen dramatically. In the high peak area, it was in double digits, but now it is around 6-7%. It was about 6.7% in 2016.

(1) From investment and export-driven model to consumption-driven model

Dr. Song said that the China’s growth model was investment-driven one. This means China’s growth predominantly relied on capital input. The consumption was subdued for a long time until recent years. In China, net export was huge because goods produced are not consumed in China. China heavily relied on export.

In 1978, when China opened itself to foreign trade, the export and import ratio in the total GDP was less than 9%. By 2014, that ratio increased to about 40%. However, it already went through the peak level. With very nice globalization and multinational trading environment, China survived a kind of pressure, but with things changing, it became very difficult for the large economy to have high degree of export dependence. China’s economy became too big to be export dependent. It used to be okay because of the globalization, but the global trend is no longer the story. The current issue of China is to change the model of growth from export dependent to the internal driven, mainly the consumption driven.

(2) Analysis from labor

(a) Demographic change and middle income trap

When china's economic growth rate had fallen, people still believed that China's economy would probably grow at least 7% to 8% for the next 15 or 20 years. However, it kept decelerating, so many people raised question whether China would fall into the middle-income trap or not.

Although there are different arguments about what are the symptoms of the meddle-income trap, and whether or not China's system allows it to break that trap, Dr. Song emphasized the labor factor and demographic is very important. In 2012, China's labor force out of the total population already peaked out, and started falling. The working age population shrunk three million a year. Three million does not sound like a big number in terms of millions of workers in China, but it highlighted that a big change started.

(b) From the period of "unlimited supply of labor" to stagnant urbanization

Dr. Song said that during the high growth period nearly 300 million workers moved from rural to urban areas, which generated enormous resource shifting effect as well as the productivity gain. It seemed that there was an unlimited supply of labor with people continuously moving from rural to urban areas. In that period, the urbanization ratio was in double digits: around 11%-12 percentage, in some years near 14%. Every year, more than ten million workers moved from rural to urban areas.

The wage costs were very low and the total cost of capital was low too, so goods made in China were competitive and exported to the global market. The only downside was the workers' wages, which were suffering because employers offered very low wages to the workers and farmers. But they were willing to accept the low wages, because of the simple reason: there was unlimited supply of labor. However, now the urbanization ratio is almost zero; last year perhaps it was in a reverse trend. Dr. Song said that the opportunities in the cities are not that promising now. Many people actually chose to move back to the countryside. In 2005, the government removed all the tax for the agricultural sector, which, in fact, may not be a good policy because such relief of burden may make farmers less care about utilizing the land efficiently. Why people want to move back? It is because of the institution or the social system. Migrant workers cannot become city residents. Even if they live in the city and are no longer farmers, they are not treated as city residents but remain as migrant workers. This is not fair, but it is the system in China. This kind of problem is there.

(c) Comparison with Japan and a window of opportunity for China

Dr. Song said that savings rate in China is still very high, it is at 51%-52%; and the investment ratio is extremely high at 47%. Domestic savings can meet the domestic demand and the excess means export. However, the growth rate of labor will become negative from now on. It may be similar to Japan. Japan used to have very high savings ratio in its high growth period before it reached its Lewis turning point in the 1960s. Now, after Japan's aging society, savings ratios are also going down. Will China follow this way? Can China become a developed country getting out of the middle-income trap?

A Japanese professor visited the ANU and said that falling savings ratio in Japan is 100% due to demographic change, and labor productivity of Japan, the output per worker, is very low now; it is almost the lowest in the OECD countries. The professor said, however, it is not a big worry for Japan because it has a deep pocket. It means that the people's wealth is still there, the per capita income is high. Japanese can handle that worry. But China is different. China is still a middle-income country, and unlike Japan, China does not have a deep pocket. Therefore, a structural adjustment is very necessary and important to lead the China's growth from now on. China has a window of opportunity in the next 5 or 10 years. Because it is really an aging society coming to China, however, it has to use the time window to do something. Regarding Japan, Dr. Song added a comment that it also needs to address the supply side issues, not demand side, not on the monetary terms, because it will not work.

(d) Labor cost increases: From Lewis era to Solow era

Dr. Song said that China is in the transition from the so-called Lewis era to the Solow era. The wages are increasing by almost double digit in China since 2004, which means the cost of production is increasing, since it no longer has the unlimited supply of labor.

The recent trend of the FDI is moving offshore, to Southeast Asia, Vietnam, Bangladesh, Sri Lanka and the economy of China has become worrisome. However, people also come to realize that even though the cost of labor is increasing in China, , the operation of industry needs at the same time some industrial links, upstream and downstream, with external economy. China already has a good industrial structure, producing goods from shirts to satellites, and the whole spectrum of industry is being produced in China. The industrial concentration is a tremendous advantage, which may surpass the disadvantage of high labor cost.

(3) Analysis from capital and efficiency

(a) Efficiency of investment and necessary reform

Dr. Song explained the efficiency of utilizing capital is worsened. In Harrod-Domar model, the total capital divided by the total output shows how much capital you need in producing a unit of output, and the higher ratio means the lower growth. Recently in China, the ratio is not only increasing, but also accelerating. If it is improving, you may see something good is happening for the financial sector, as these sectors may try to transfer the savings to productive use more efficiently. But the fact is it is rising. The efficiency of utilizing of the capital and all the productivity improvement are no longer there. That is a serious problem. Because, if you do not have this kind of productivity, how can you guarantee the return to the capital or efficiency of utilizing capital in the system? Too much capital exists there in the system. How to utilize them efficiently is a big worry at this moment.

Dr. Song said that this is the reason why the Chinese government began emphasizing new reforms, the supply side reforms. It should raise the productivity now. China is rebalancing from investment driven to consumption driven economy, moving from export dependent to internal dependent model. The source of growth in the new model is innovation, human capital, and technology improvement. China needs more in reforms.

(b) Private sector and public sector: inefficiency of resource allocation

Dr. Song explained why the utilization of capital became so inefficient especially after the Global Financial Crisis when China had a massive stimulating package put in place. The utilization of capital fell over time. When it became relatively of a low return or a falling return, investment also fell. This is alarming for the Chinese economy. The growth rate of fixed asset investment used to be more than 25% y/y in the high growth period. Now the rate fell to 10% y/y. When the utilization of capital is not promising and the return to investment is not promising, people do not want to invest. It is also very interesting to see the savings-invest gaps and the current account surpluses. It still has the higher savings than the investment, but the gap is narrowing and the surplus is narrowing as well. In addition, the foreign exchange reserves also fell dramatically. From the peak level of 3.8 trillion dollars, it decreased to less than 3 trillion dollars.

Dr. Song said the problem in China now is that the private investment is being compromised too much and the state firms are becoming too dominant, especially in the monopoly sector. Net profit to the total asset in the private sector is much higher than the State-Owned Enterprises (SOEs), and the gap is widening. However, the private sector must pay a much higher interest rate in borrowing from informal financial sector. The simple fact is that the resource is not allocated properly, and the resource did not go into the most efficient sector of the economy. Of course, the private sector is borrowing at shadow interest rate, which is called informal financial sector. They have to pay as much as 40% compared to SOEs that are guaranteed to borrow with interest rate of only 4% or 5%.

Dr. Song said that the private companies are most efficient but their investment is falling now. Growth rate of the overall fixed asset investment and the share of private investment in total continue to fall. This is probably one of the most alarming things for China.

(c) A view from the Solow theory

In the early and middle phase of reform, China enjoyed high efficiency because labor and capital were all efficiently utilized. The capital utilization became inefficient because of very simple reasons. The first is the extremely high labor-land ratio of China under the central planning commune system which did not allow people to move. The labor-land ratio was very high, so the agricultural productivity was very low. When the reform started to let the labor move, agricultural productivity improved. Labor in the industrial sector increased and the capital-labor ratio became lower, so the capital efficiency improved.

In an aging society in China, the supply of labor becomes smaller. At the same time, there are very high savings to provide the source of capital, which makes the capital-labor ratio becoming higher.

In the Solow theory, higher ratio of capital-labor ratio is subject to a diminishing return. Labor shortage and plenty of capital to be utilized in favor of SOEs in terms of financing will cause inefficiency. Increasing capital-labor ratio causes a diminishing return of capital. Only at one condition, it can be changed to improve the labor productivity. With increasing the labor productivity, even when the capital-labor ratio continues to increase, the capital return ratio could be raised. That is why the strategy of the Chinese government goes with technology innovation and human capital. When the labor is shrinking, the capital efficiency has to be made by the system, to improve the efficiency of utilizing those resources: Technology, innovation, and human capital etc.

(4) Entrepreneurship and institution

Dr. Song explained that entrepreneurship is so important because they can actually lead to efficient investment in a certain area. As a result, this kind of micro structural changes, can take place and an overall growth can be underpinned. In order to nurture entrepreneurship, you need the institution. The preferences and values are needed, but China is very much lacking in emphasizing on that social capital, institution that nurtures entrepreneurship.

Chinese people are traditionally very entrepreneurial, but we need to answer questions about those two things: the patience and risk tolerance. China has implemented family planning for more than 30 years, so the families have only one child for the whole three generations. Those kids are at the centers of families and society. It may be hard for such kids to have those two attributes of patience and risk tolerance and thereby it may potentially compromise the future growth of China.

(5) Adaptive efficiency and the basic market functions

Dr. Song briefly explained about the supply side reform and about how to measure it. He linked two things: adaptive efficiency and market functions.

In an early thinking about reform, it was based on an understanding that price would work for allocation. Only by getting price right, the market would go all right. But it did not work. Then, people realized that policy should also be right. Getting policy right did not work in many societies, especially in developing countries. Then, people say we have to get institution right, and some worked, some did not work. Within that institution, there is one important thing: how to treat the institution changes; this is so-called adaptive efficiency. That is much broader than allocative efficiency. Allocating resources through market is too narrowly defined and narrowly applied. Dr. Song said that if we have much broader thinking about market functions, there are three of them: allocative, creative and discovery.

Dr. Song drew the connections between studies of two Nobel Prize scholars, Dr. James M. Buchanan and Dr. Douglass North who studied about adaptive efficiency, and developed the framework. For the next phase of development of transitional economy of China, this kind of perspective is much needed.

The market has other functions as well. If you think of all the functions, institutional changes become multi-dimensional. It is not a purely go market with going over the state. They actually can be combined in some sense to move forward to improve adaptive efficiency, the efficiency of the total society. Of course, the measures for adaptive efficiency can be the reduction of transaction costs.

Here, due to the time limit, Dr. Song's lecture came to the end and the question and answer session began as below.

Question & Answer Session

<Question from an attendee (1)>

Thank you very much, Dr. Song, I have two questions.

The first question is that as you mentioned, the ratio of total capital spending against GDP is very high, higher than 30%. But at the same time, the growth of GDP is getting lower. I think such movements mean lower capital-output ratio, but your graph shows it is getting higher even after 2009. Although your graph does not cover last 4 years, since 2013 to 2016, would you add some explanation? Is it still getting higher or not?

My second question is about something you did not mention. Most economists including me, pay attention to the very high growing credits in China in private sector. At the same time, the growth rate is getting lower, which nears 6%. I think such movement is not sustainable in the long run. If I say it more frankly, I think China's current economy is in the process of a huge credit bubble. Please add your comment on this issue. Thank you very much.

<Response from Dr. Song>

They are very interesting questions, especially the second one. People always think whether China is repeating what Japan did in the early 1980s and early 90s when the crash took place, so let me move back a little bit further in answering your second question.

On the credit expansion in responding to the low growth of the economy, and looking at what happened to Japan and China, I think there are common things. If you recall on the labor changes, we can see the falling of labor growth rate and the inefficiency of capital, which means the capital-output ratio continues to increase, and the TFP is near zero. These two figures express one indication, one term that is called the potential growth rate of the economy. Potential growth rate is the growth rate of labor force plus the productivity, and we know the growth rate of labor growth is already negative, and the productivity growth is almost coming to zero. That means the potential growth rate in China must be very low, or relatively low now.

The similar thing is for Japan, the working population in Japan is shrinking, and at the same time, there is not much improvement of productivity at all. We can see China's potential growth rate may be still relatively high, because the current aging is not too serious yet. In the next 30 years, that will be very severe. Last month, there was a release of population figure, showing China will have a very high ratio of aged population, and it changes very quickly.

Now come back to now, when you have a relatively low growth rate, so what do you do? One thing is to have a credit expansion. Japan has been doing it for years, and China started doing that in the second half of last year, 2016, because the growth slowed. The leaders do not want this happen, as this year there is a Party Congress in China. Therefore, there are certain measures in place to generate the growth, so the credit expansion also became quite extraordinary. If the potential growth rate is low, the real measure to deal with the growth is to address the supply side. If the labor is falling, what do you do? Let families have more children. Of course, this is on the track but we cannot have the immediate effect. Increasing the participation rate, letting women get back to work very soon, is very quick. China has the tradition that women always go to work after getting married, but not in Japan, right? There is a certain potential here in Japan, but there is also the cultural factor in that case.

I think there are certain risks for credit expansion: to what extent that can be corrected. It depends on the growth momentum. It depends on how the reform measures put in place. At the same time, I mentioned about resource allocation. I should emphasize that the resource should flow into the most productive area, through entrepreneurship, through the private investment, rather than the state controlled sectors.

The government also started tackling the SOEs problem, and certain monopolies started being reformed. The downstream of the oil industry is being opened for the foreign competition, and the regulatory changes are happening as well. The question is that it is a kind of compromise. If you want to grow in the short run, you stimulate, but stimulation causes the structural problems, so you have to clean up them a bit later on. But you do not want the growth to suffer too much, so you have to stimulate a little bit, right? However, the real issue is to address the supply side, but it will take more time than the politicians want to see. They want to see the growth immediately. There are so many uncertain things for the real estate and the stock market, so a lot of people do not want to invest in those areas. That is why the capital flight, the money flows overseas in a very dramatic speed. The reserves shrunk in size in 2014 and 2015, now is below three trillion dollars, and the government is imposing constraints to control the flying capital again, reflecting this trend.

I think the government needs to maintain the balance. They do not want the growth falls very quickly or dramatically, but they do not want a dramatic stimulus package. As all those we mentioned about inefficiency were very much due to the stimulus package in responding to the Global Financial Crisis. There was no other solution. Europe, North America and Japan were all coming down, so China said it has something to do with it. At that time, it was a consensus, but now you can see the legacy of that one. Overcapacity problem has been mentioned. So we cannot have a very clear answer to the question.

The first question is about rising capital-output ratio and about whether the trend will continue or not. When you have more capital to add, that ratio will continue to increase (meaning that efficiency lowered). I guess the reforms will take time, the forecast for China by the Chinese Academy of Social Sciences (CASS) and Professor Cai Fang (蔡昉) is certainly not a V shape recovery, nor a U shape, and it may look like an L shape. And the growth may continue to be at the lowering in the next five years.

Over those five years, there is a window of opportunity. It is so critical to get the system right on the supply side. Therefore, efficiency can be improved, so that ratio may not be increasing over time, but on the other hand, if it is slow in reforming on the supply side, that trend will continue, that is no doubt.

<Question from an attendee (2)>

I have a question about China's structural reform that started last year and just finished. The government says they achieved quite a lot of results by cutting overcapacity, and excess productivity, but some economists say with prices getting higher, especially for coals and steels, the cut capacity may recover in the future so we cannot say China can achieve its goal in a short term, what is your comment about this problem? Thank you.

<Response from Dr. Song>

This is also a very interesting observation, since the second half of last year we know that Australia has been very keen about what is going on in China. Because it's resource-based economy, we had the super resource boom from 2003 to 2013 because of the demand from China. after that the commodity prices all come down, it looked like the trend continued until the second half of last year, but the iron price is about 90 dollars again,

China decided, because of overcapacity, to remove 1 million tons of capacity in the next few years, I did some survey in Tangshan (唐山) and Shijiazhuang (石家荘) and visited the steel mills and in fact, in some provinces, especially in Hebei (河北), the provincial government is doing something, but the overall, trimming that overcapacity is quite difficult, because the local governments do not want to do it, because of tax and employment.

I think imposing a certain regulation is happening. but at the same time, it depends on credit expansion in responding to a slow growth of economy. When a little bit of the stimulus package is added to that one, that resource, the construction, and the demand of steel, all come back a little bit, that's contradictory. But scholars forecast that this spike is short, and it will not last. The overall structure is still moving into industrial restructuring, and it will continue to happen, especially when the growth is being stabilized. But if it is not, maybe there is further stimulus package on the track in the middle of this year. Then you can see perhaps the commodity price would continue to increase, overcapacity problem will continue to exist because of the expansion, and what will happen after that? For the very first time, in our modern history, global growth of export, trade, is growing slower than the global GDP since 2012, which never happened before in the entire post-war period. The growth rate of trade is always higher than the growth rate of GDP, which makes the trade become an engine of global growth. China is a big beneficiary of that one. Highly dependent on trading but now we see that engine is losing steam, because of the process of de-globalization, and with the Donald Trump's election in the U.S., it becomes worrisome. Even before that one, you can see the rising protectionism everywhere, especially over the developed countries. So, China will suffer in a way because China cannot take it for granted that all the goods are continuously exported. The hope is that China can increase from the demand side, which is consumption, in the case that consumption is lower than capital investment, lower than the trade dependence ratio. Anyway, I already mentioned China is just too big to be an export-dependent economy. Everyone is adjusted to a shock of the global system, but not quick enough to absorb and accommodate China’s, when you have millions of millions of workers suddenly came into a global system as a shock, then everything needs to be adjusted. In the western society, where the democracy and domestic politics interlace with that of globalization, you can see why Trump is being elected. Very obviously, when the middle class and poor people are being marginalized, they are not benefitted from the globalization. For 50% of the American population, their real income did not increase at all in the past 15 or 20 years, and for the top 1% of American people their real income increased 300%. That is the statistic.

You need global governance, we have WTO, we need some kind of global income redistribution among the countries, among the different sectors of the society, and those are the lighting in nowadays. Japan and China may jointly push for the regional integration and globalization, otherwise, we will see the reversal of globalization, it happened in the history. From 1870 to the WWI, there was a golden period for the globalization, but that became a very dark period because of wars, in between there was a great depression, and in postwar we have another golden age, right? Again no longer. We are now living in the new era, so China, Japan, and others have a lot to do jointly and to confront the new challenges.

<Question from an attendee (3)>

Thank you very much for a very interesting lecture, I strongly realized that now China is having the same problem that Japan had in 20 years ago and that addressing the supply side reform is very important, I agree. But it is a difficult one. At that time, the Japanese corporations are cutting employment and refraining from investment in order to improve the efficiency at the enterprise level. This is very easy way to improve the efficiency and profitability and increment the ROE. I think China would not follow this Japanese story, but also there is a possibility that China will follow the Japanese way, causing deflation. What do you think about the future?

<Response from Dr. Song>

That is a tough question. That is a very good question. We see the high leverage ratio of growth is a global trend that almost has no exceptional case. North America, Australia, New Zealand, Japan, the EU, they all have very high leverage, basically the debt to GDP ratio is too high, of course Japan's extremely high, the EU and others are all very high, so our growth is based on the debts. I read the Japan News today; there is one thing about Ms. Janet Yellen, the Chair of Federal Reserve. In the picture of reporting to the congress, at her back, there was a big screen, to show the total debt of the U.S.. Guess what? Nearly 20 trillion dollars. That is the message she said, it is very open and transparent. The big thing for the world community to confront now is how to deleverage. In order to achieve sustainable long-term growth, not only for our generation, but for our children and children's children generation, we have to be responsible for them. How can they survive with such high level of debt on their shoulder? There is no way. However, as you said, deleveraging will compromise your growth, which takes the steam out of the engine, so this is tough choice for the politicians. Politicians cannot be responsible for long term, but just in the short term like 2-3 years, we need growth because of the need for reelection, and the only way is to increase the debt level, this backs to my point about growth rate. When the potential growth rate is low, let's do something from the supply side, labor participation, birth policy, marry earlier to have more children more quickly and don't delay, that's the only way. The emergence is that Japan has to save itself, get marry earlier and have more kids. Importantly, we also answer the question that Japan was so innovative in the past, why not now. The attention has moved to age care, to look after the old people, for China would have the same thing.

China also has a very clear strategy, which is high technology. This relates to another debate right now, which is about whether the fourth industrial revolution is happening. Klaus Schwab, the chairman of the World Economic Forum, believes that the fourth technological revolution is happening. Robert Golden from U.S. said it is not happening, because we do not see global productivity improvement, no country has huge productivity increment. It is all falling, Australia is falling, Japan is falling as I mentioned in my presentation, and the EU is falling except Germany. Whether that is happening or not, I am an optimistic person, otherwise, where is the hope for us?

On the one hand, on the very high debt to GDP ratio, we are all aging. There is one hope that I wrote in my article. Northeast Asia, China, Japan, and Korea, should cooperate with South Asia including India, Pakistan and Southeast Asia, as they have young population. Such cooperation will help push them to the frontier of industrialization. Back to your question about the potential bubble, we can see that bubble is almost associated with the global economy in the history. It is all about up and down, the burst then do it again.

<Question from an attendee (4)>

How do you evaluate the achievement of the AIIB in the first 2 years?

<Response from Dr. Song>

I do not know much about the operational side of the AIIB. I know that there are some doubts from other countries about the governance system led by China, as such an important initiative, and whether they can keep running on that one. But I think the records show that they are actually following the global standard in running that one but the most encouragingly is that the AIIB has a joint project with ADB, and another joint project with the Word Bank, so that means it's clear, it's not just China exclusive organization, it's actually in collaboration with other players.

I think the One Belt One Road is often compared with the Marshall Plan in the post-War period. The, US had 100 billion dollars investment in Europe, which generated the post war growth in Europe and globally as well. We were talking about the difference of whether the fourth industrial revolution is happening or not. I think the world economy needs an impetus. We need something new; we need something to give a boost to the growth. In that sense, I think the One Belt One Road is one of them and it is very important, it is not pure infrastructure development, it’s also a movement of the old silk road, through Central Asia to Western Europe where they generate massive investment demand not through fighting the wars. I think that is the worst scenario to increase demand through fighting wars. So we need to be very firm to do something through this kind of project to generate demand by investment. I think the world should give China a chance to do that one, although there are many problems. The security issues are along the way of that road, so we have to walk through that one. There is a very strong geopolitical implication of that one as well, but it looks like the project starts taking off, so let us see, give it a few years and see how it is effective. If that's a good one, people can make that investment, in the area which has been neglected when industrial revolution took place in Europe, in Great Britain, moving to continental Europe, then across the Atlantic to North America, after the war, it moved to the Asia across the Pacific, to Japan, Asia and etc. There is further job to do across the Eurasia continent to make it fully completed, right? There are needs there, like lack of development, lack of investment. So why not give the chance to connect them as well, when you build the connection through Eurasia continent, I think that changes the world economy's landscape, which offers more opportunities as more countries are involved in the project.

<End>

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