

## Slowdown of growth in China: Circumstances or choice?

*If the past experience of economic miracles is any guide, the slowdown of growth in China should either take place in a couple of decades rather than now, or it should not happen at all.*

By **Vladimir Popov** January 28, 2019

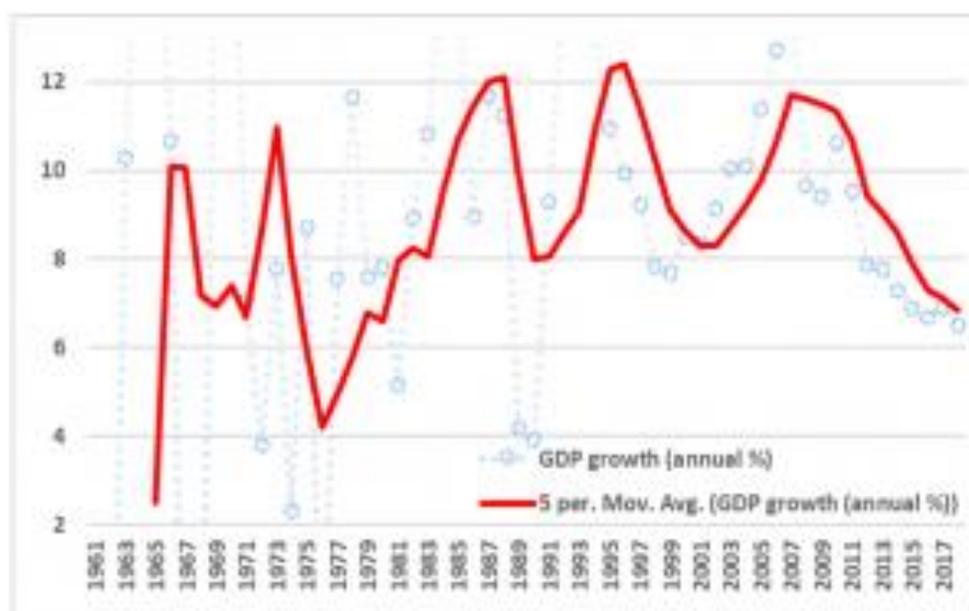


In 2007, Chinese GDP grew by 14%. Since that time growth rates have almost continuously fallen and amounted to only 6.6% in 2018 (fig. 1). Five year moving averages for growth rates today are at their lowest level since the beginning of reforms in 1978, 40 years ago.

Many economists point to objective factors that have led to the slowdown. One is the decline in population growth rates and the

ageing of the Chinese population due to the one-child policy. The impact of this factor is real, but not that large. The working age population and employment both grew at 2% annually from the 1980s to the 2000s, but growth later declined and came to a complete halt. Since 2014, the working age population has not grown. This can explain the decline in the GDP growth rate by two percentage points a year, say from 10% to 8%.

**Figure 1: Annual growth rates of GDP (%)**



Source: [World Development Indicators](#)

The other objective factor is the exhaustion of the advantages of economic backwardness: it is easier to catch up from a low base, especially because introducing cutting-edge innovation is more difficult and costlier than copying pre-existing technologies, either for free or even by paying for technology transfers by buying patents and

copyrights. This is a very valid argument: developed economies have never grown at the 10% rate of East Asia's economic miracle economies, and growth always slowed down in fast-growing countries when they approached the technological frontier.

Only five countries/territories have ever made the transition in status from 'developing' (i.e., less than 20% of US per capita income) to 'developed' (over 50% of US per capita income). This happened between the 1950s and the 1980s in Japan, South Korea, Taiwan, Hong Kong, and Singapore.

But the slowdown in growth in these countries and territories, if it occurred, took place when per capita income was over 50% of the US level, whereas Chinese per capita GDP (at purchasing power parity, i.e., in comparable prices) is currently below 25% of the US level (fig. 2). In fact, a marked slowdown only occurred in Japan and Hong Kong, whereas other 'tigers' continued to grow at pretty high rates even after they became rich, bypassing the infamous 'middle-income trap' at high speed (fig. 2).

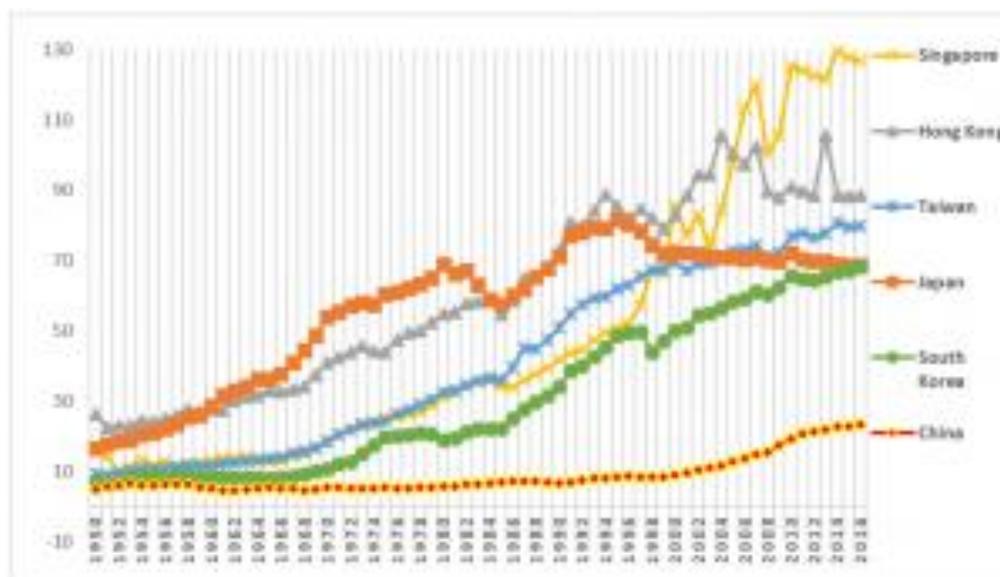
If the past experience of economic miracles is any guide, the slowdown of growth in China should either take place in a couple of decades rather than now, or it should not happen at all.

There are, however, important factors associated not with circumstance, but with choice: economic policy changes. For four decades, the Chinese growth model was based on under-pricing the exchange rate through an accumulation of foreign exchange reserves

(FOREX), which pushed up exports and investment in absolute terms and as a share of GDP (figs. 3-6). An undervaluation of the national currency is a powerful industrial-policy tool which promotes export-oriented development (Polterovich and Popov, 2004). In this respect, China emulated the aforementioned countries' economic miracles.

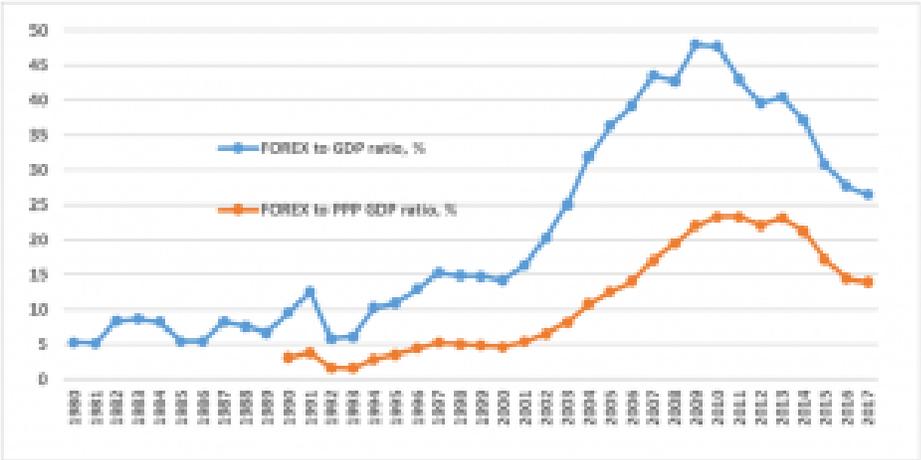
Since the 2000s, however, China has very much been under US pressure to let the Yuan appreciate. The US, the International Monetary Fund, and the World Bank, accused China of 'manipulating' the exchange rate to gain an unfair competitive advantages in international trade, claiming this contributed to 'global imbalances', i.e., to a huge US current-account deficit in trade with China (Popov, 2010; Popov, 2013).

**Figure 2: PPP GDP per capita in some East Asian 'economic miracle' countries and in China as a percentage of US levels**



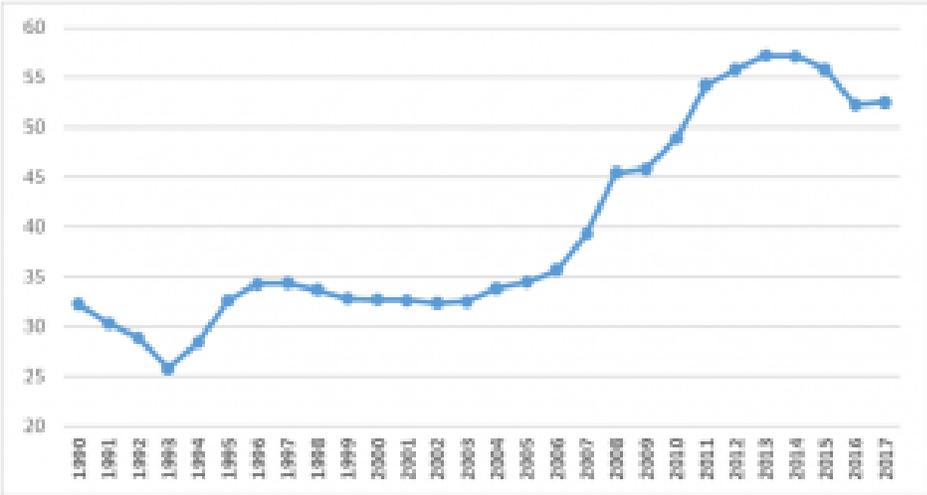
Source: [Maddison project database \(2018\)](#)

**Figure 3: Foreign exchange reserves as a percentage of GDP and PPP GDP**



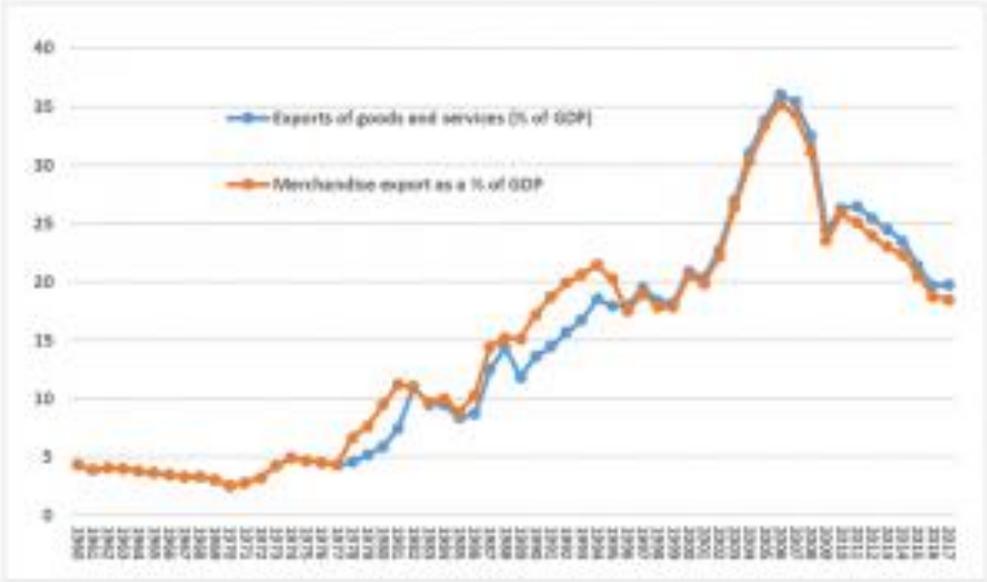
Source: [World Development Indicators](#)

**Figure 4: Real exchange rate of the Chinese Yuan; ratio of Chinese to international prices, as measured by the ratio of dollar GDP at the official exchange rate to PPP GDP (%)**



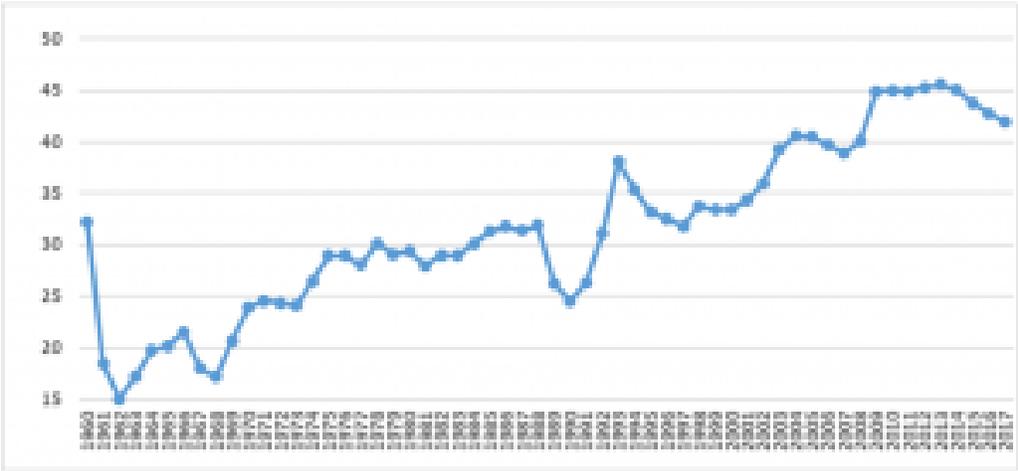
Source: [World Development Indicators](#)

**Figure 5: Merchandise exports and exports of goods and services as a percentage of GDP**



Source: [World Development Indicators](#)

**Figure 6: Gross fixed capital formation as a percentage of GDP**



Source: [World Development Indicators](#)

Since the beginning of the 2000s, China has slowed down its accumulation of FOREX. From 2010, it stopped this accumulation completely (fig. 3). The real exchange rate appreciated greatly over the 2003-2013 period (fig. 4), exports as a percentage of GDP reached a high (35%) in 2005 then began to fall (fig. 5), and the share of investment in GDP peaked in 2013 (45%) then began to decline (fig. 6). The Chinese model of rapid export-oriented growth based on the accumulation of FOREX to underprice the exchange rate, contributing to high exports, savings, and investment (Polterovich, Popov, 2004) began to give way to one oriented towards domestic consumption (Popov, 2010; Popov, 2013). The inevitable consequence was a decline in growth rates (fig. 1).

During the 2008-09 Great Recession, China temporarily stopped the appreciation of the Yuan and put into place a huge stimulus package, so that the economy only slowed down marginally (from 14% in 2007 to 9% in 2009). If the world economy goes into recession this year, will China react the same way?

## **References**

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