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UTVIKLINGEN I KINA

POLITISKE OG ØKONOMISKE VURDERINGER

Introduction

- Have you read ”Wild Swans: Three daughters of China”, written by Jung Chang?

- The Middle Kingdom’s history stretches back 5-6000 years

- Today, 1.3 billion Chinese. GDP equal to that of France. Risen by a factor of seven since 1978

- 7 % growth and GDP doubles in 10 years

- Market economy is developing

  $\Rightarrow$ Free to choose

- Tianamen Square 4 June 1989

  $\Rightarrow$ Political reforms are frozen. No choice

$\Rightarrow$ Are the two compatible in the long run?

- Legitimacy to the existing regime by delivering continued economic growth, benefiting most of the people most of the time

- Hu Jintao takes over for Jiang Zemin:
  - November 2002 as Party Chief
  - March 2003 as President
  - September 2004 as Supreme commander of armed forces

- Wen Jiabao is prime minister

- Hu and Wen have substituted political reform with bureaucratic reform

⇒ Make government officials more accountable. But not politicians accountable to the people through democratic and free elections

- Develop ”harmonious” society
  - Migrant workers need better deals

- Beyond criticism are the Party and the Top Echelons of it. Need for something else to critize and protest against?

- ”It is a problem to get rid of the problem of corruption”
  - Why is it a problem to get rid of a problem?

Will focus on:

- Banking
- FDI
- Investment
- International Trade
- Exchange rate policy
- Consequences for
  - The US
  - Norway

Banking

- Four large State Owned Banks (SOBs). Lend primarily to State Owned Enterprises (SOEs). 60 % of credit supply from SOBs
- SOBs are in a mess. Technically insolvent
- Need more than 200 bn USD to capitalize four large state owned banks
- Want foreign strategic investors
- August 2004: HSBC buys 19,9 % of Bank of Communication (fifth largest bank)

- Non-performing loans (NPLs) in China, 20-30 % of loans outstanding
- Excessive investments and lending in 2003-2004

  $\Rightarrow$ NPLs may increase in the downturn
- Loans considered as a form of ”social welfare”

- Lending rates are now free to vary. Significant improvement. SOBs will lend more to private sector
- Lack of collateral. Margins must be higher

Fred Hu (Goldman Sachs), largest risk to the Chinese economy:

”Banks continue their unsound lending and poor risk management”

- Stock market has been slow to develop
- Shanghai index lost 50 % in 4 years
- Loosers may be compensated
- Government owns 2/3 of listed stocks (total value of which is about 400 bn. USD)
- Long run project to have 240 bn. USD worth of stocks put on the market
- Pension funds (and other owners of financial assets) in China have a very limited menu to choose from

- OECD has a more optimistic view (in report due in September):
  - – Growth can continue for many years at 9 %
  - – Rates of return are good
  - – Only 2 % of bank loans since 2000 are NPLs
  - – Public debt less then 25 % of GDP
  - – Low tax on capital
  - – Market economy is working reasonably well
    - 1978: All prices determined by the state
    - 2003: Only 10 % are determined centrally

Foreign Direct Investments (FDIs)

- 2003, FDI in China
    4 bill. USD from the US
    4 bill. USD from EU

- Total FDI from the US is 40-50 bill. USD

- As much European investment in Texas alone as all US investment in Japan and China put together.

- 2003: USA invested
  - 4.1 bill. USD in Denmark
  - 1.5 bill. USD in India
  - 19.0 bill. USD in the Netherlands
  - 22.0 bill. USD in the whole of Asia

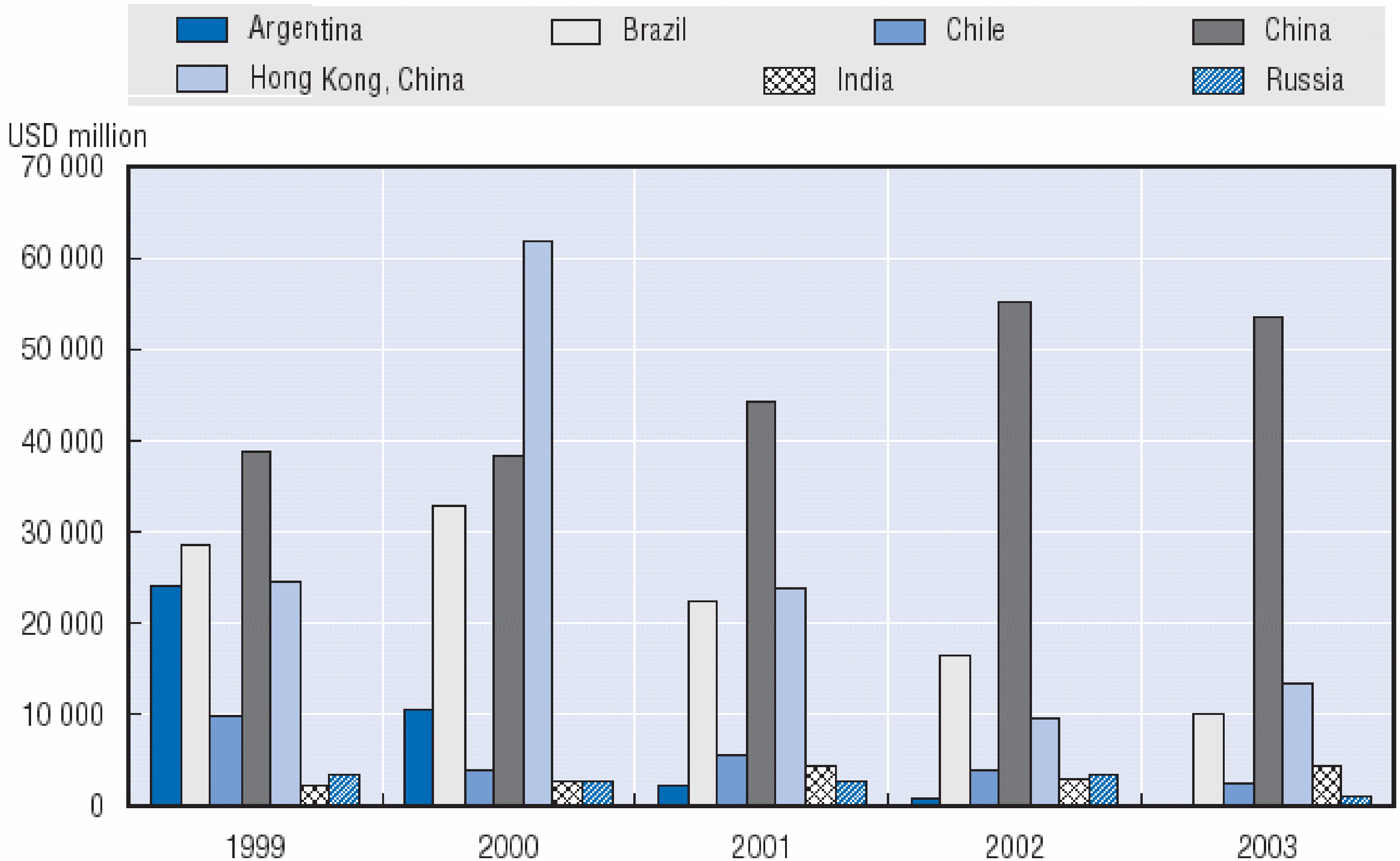
- Modest R&D in China. Need FDI to obtain access to new technology
- Less than 10 % of direct investement from abroad

Where Is China's FDI From?

(In US$ bn of FDI Utilized)

Source	**1996**	**1998**	**2000**	**2001**	**2002**
Hong Kong	21,3	18,9	15,9	17	17,8
Taiwan	3,5	2,9	2,3	3	4
Singapore	2,2	3,4	2,2	2,1	2,3
Japan	3,7	3,4	2,9	4,4	4,2
Korea	1,4	1,8	1,5	2,2	2,7
Subtotal	**32,1**	**30,4**	**24,8**	**28,7**	**31**
US	3,4	3,9	4,4	4,4	5,4
Virgin Island	0,5	4	3,8	5	6,1
Total Utilized	**41,7**	**45,4**	**40,4**	**46,9**	**52,7**

Figure 1.1. **FDI inflows to developing and other countries**



Source: IMF International Financial Statistics and national sources.

Investment

- More than 40 % of GDP allocated to real investment
- Domestically financed
- More than 50 % of real investment by state sector
- Provincial governments keep increasing real investment. Real danger: Excess capacity
- Wen Jiabao orders tightening of lending (April 2004)
- Higher interest rate may attract foreign capital and put upward pressure on the exchange rate.

1 USD = 8,28 RMB since 1995

- Why don't the Chinese consume more?
  65% of GDP to private consumption in the 1980s
  Only 54 % in 2003

- People feel insecure and save
  - One-child policy
    - Save for education of child
    - Save for own old age
  - 100 mill. workers stripped for social security in SOEs
  - Banks are broke, and future taxes may have to increase
  - Health and education increasingly privatized

International trade on the increase

- Export in 1977: 5 % of GDP
- Exports in 1999: 20 % of GDP
- Exports in 2004: 35 % of GDP

- Trade now equally much with
  - Japan
  - USA
  - EU

- Huge surpluses against the US, ca. 162 bill. USD in 2004, partly matched by deficits of about 100 bill. USD towards rest of the world

- <u>Exchange rate policy</u>
  - Keep the peg
  - Peg to a basket
  - Revalue, and then peg to a basket
  - Free float and Inflation Targeting

- Flexible exchange rate, and can use monetary policy to stabilize the domestic economy
- Capital account transactions will only be liberalized gradually
- Peoples Bank of China (PBC), more than 600 bn. USD in reserves. Problem to diversify. Why?

Consequences for the US

- US trade balance cannot keep growing
- 20 % appreciation of RMB would not correct the imbalance. 70 % import content in Chinese exports
- But would reduce the pressure on the euro a bit
- US consumers benefit from trade with China
- But some groups lose – more so outside the US – like manufacturers in countries like Mexico

- New and rising powers will inevitably confront with the existing hegemon. Is it necessarily so?
- China’s ”Peaceful Ascendance Strategy” is it credible and realistic?

- More than one hundred years back, Germany and Japan were not peacefully integrated as powerful nations. What should the US do these days?
- What legacy does the US want to leave behind?

Consequences for Norway

- Norway benefits from terms of trade improvments. Oil and raw materials more expensive; finished goods less expensive
- Shipbuilding and shipping also capitalize on rapid economic growth in China
- Inflation targeting has become more difficult
- Too low domestic interest rate? Asset market inflation which may destabilize the economy later?
- The NOK may become a safe haven, and too strong, if currency markets destabilizes as China hits the wall