China's Role in the Global Economy

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INTRODUCTION

Since 1978 China has seen consistently high growth rates as a result of the major economic reforms launched two years after the death of Mao Zedong. Since then China has been a centrally planned economy combined with market economy in designated zones.

The economic development has multiplied the significance of China in the global economy since the late 1970s, although China's share of global GDP and trade does not reflect the size of its population, cf. Tables 1 and 2. For comparison, Chinas GDP is 7 times that of Denmark.

CHINA'S WEIGHT IN THE GLOBAL ECONOMY — Table 1

China's global percentage	GDP	Trade	Population
1977	0.7	0.6	22.4
1982	0.9	1.2	22.0
1987	1.4	1.7	21.7
1992	1.8	2.2	21.5
1997	2.7	2.9	21.1
2002	3.4	4.8	20.7

Source: Figures for GDP (constant prices) and population are from the World Bank, while trade figures are from the IMF.

THE WORLD'S LARGEST ECONOMIES IN 2002 — Table 2

	Percentage of global GDP	GDP growth (in per cent)	Percentage of global population	GNI per capita (US dollars)
USA	32.3	2.3	4.7	35,060
Japan	12.3	-0.7	2.1	33,550
Germany	6.1	0.2	1.3	22,670
UK	4.8	1.5	0.9	25,250
France	4.4	1.0	1.0	22,010
China	3.8	8.0	20.7	940
Italy	3.7	0.4	0.9	18,960
World	100.0	1.7	100.0	5,080
Memo: Euro area	20.5	0.7	4.9	20,230

Note: China's share of global GDP is 12 per cent measured by purchasing-power parity, which is primarily of significance to Chinese welfare.
Source: World Bank. GDP in current prices.

Today China is the world's sixth largest economy measured by GDP. In spite of the sustained high growth rates it lags far behind the USA and Japan, and the gross national income per capita is very low, even when compared with the world average.[1] However, poverty halved during the 1990s so that only 16 per cent of the Chinese population lived on less than 1 US dollar a day in 2000.[2]

The decentralised development model has created regional differences as regards income level, infrastructure, etc., particularly between inland China and the more wealthy coastal areas in Eastern China. This means that the most affluent fifth of the population account for almost half of total consumption.[3]

China's growth has primarily been driven by market-oriented reforms and the opening of the Chinese economy to the rest of the world. Combined with low production costs, the liberalisation measures in recent years have lead to significant increases in exports and foreign direct investments. The high level of foreign demand strengthens China's position in the region and in the world, but also entails increased focus on whether China's growth is taking place at the cost of other countries.

CHINA'S OPENING TO THE WORLD

Politically China has aimed for a more constructive and diplomatic line, which means that China is gradually being recognised as a super power. President Hu Jintao was the first Chinese leader ever to participate in a G8 meeting in 2003. In economic terms, the new openness has so far focused on trade and foreign direct investments, while capital restrictions still play a major role in the financial area.

Both politically and economically China's accession to the World Trade Organisation, WTO, on 11 December 2001 was a landmark event. The WTO commitments require extensive adjustments of Chinese economy and legislation, cf. the Box. At the same time the various sectors within the Chinese economy must prepare for increased competition.

Merchandise trade

China's merchandise trade has increased by an average of just over 15 per cent annually during the last 20 years. Focus tends to be on exports, but growth in imports has not been significantly lower. In 2002 exports accounted for 26 per cent of GDP, while imports accounted for 24 per

1 China's gross national income per capita is also low if calculated in purchasing-power-parity terms. According to the World Bank it was 4,390 dollars in 2002, against 7,570 dollars globally (World Development Indicators, WDI, 2003).

2 World Bank.

3 Cf. the *UN Human Development Report* 2003.

CHINA'S ACCESSION TO THE WTO Box

China joined the WTO on 11 December 2001 after 15 years of negotiations. In that connection China committed itself to non-discriminatory treatment of all WTO members, so that foreign enterprises are not treated less favourably than Chinese enterprises. Likewise, Chinese goods produced for respectively export and domestic sale must be treated equally. Implementation will take place via a revision of Chinese legislation to bring it into full compliance with the terms of the WTO Agreement.

The agreement between the WTO and China is extensive and includes specific schedules for adaptation in a great many areas. The following should be emphasised:

- *Goods*. Gradual elimination or reduction of tariffs, primarily in 2004, but by 2010 at the latest. On average tariffs for agricultural products are lowered to 15 per cent, while tariffs for industrial goods are lowered to 8.9 per cent. China must limit subsidies for agricultural production to 8.5 per cent of output. As for all WTO members, quotas on textiles must be abolished by 31 December 2004, but until end-2008 WTO members may limit textile imports from China in the event of significant market disruptions.
- *Services*. As regards financial institutions, foreign institutions may provide trans actions in foreign currency upon Chinas accession. Two years after accession the foreign institutions may provide transactions in local currency to Chinese enterprises. Five years after accession all restrictions must be abolished. As regards insurance companies, there will be a gradual opening to foreign ownership. Two years after the accession 100 per cent foreign-owned companies will be permitted within non-life insurance – for other types of insurance 100 per cent foreign-owned companies will not be permitted until five years after accession.

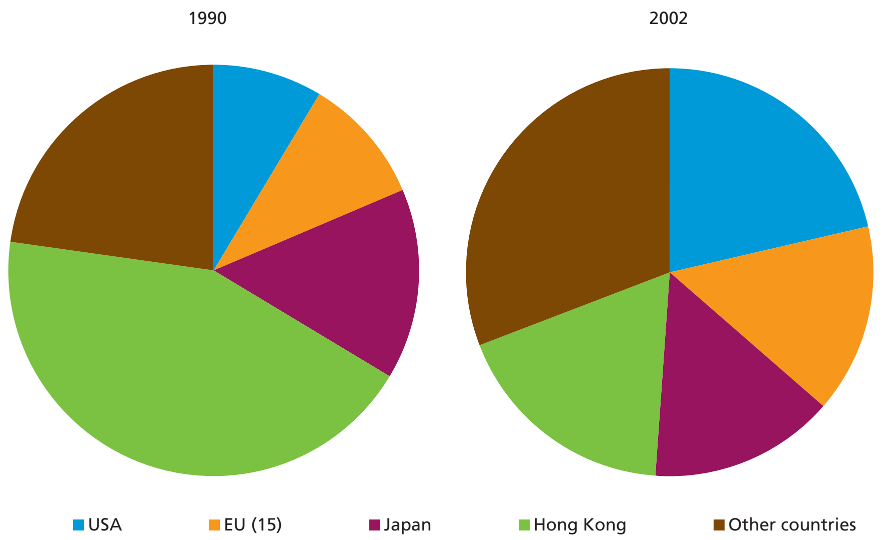
Source: WTO.

cent. For comparison, exports and imports made up respectively 33 and 28 per cent of Denmark's GDP in 2002.[1] China's largest trading partner is Japan, with 17 per cent of China's total trade, followed by the USA and Hong Kong at respectively 16 and 11 per cent.[2] Hong Kong's importance fell significantly up through the 1990s, cf. Chart 1. Today the USA, Japan and Hong Kong jointly account for approximately 55 per cent of China's exports. To a higher degree than its exports, China's imports are distributed on many different countries, with Japan, Hong Kong, Taiwan, the USA and Korea as the key trading partners.

Overall the structure of China's merchandise trade does not differ essentially from that of industrialised countries – such as the USA – characterised by a large share of manufactures and limited trade in agricultural products, cf. Table 3. Japan, however, differs significantly from both the USA and China, since imports of mining and agricultural prod-

1 Source: IMF Direction of Trade Statistics, the World Bank and Statistics Denmark.
2 All figures for Hong Kong are subject to reservations owing to the registration method for transit trade. Hong Kong's key role in Chinese trading also leads to more general differences in the bilateral trade figures provided by China and the individual trading partner.

DESTINATIONS FOR CHINESE EXPORTS Chart 1



Source: Direction of Trade Statistics, IMF.

ucts are considerable. A major difference between the three countries is seen in exports of machinery and transport equipment, which for the USA - and in particular for Japan - are by far the most important export group. Approximately 40 per cent of China's exports comprises products such as clothing, textiles, footwear and toys.

China mainly exports low-priced, labour-intensive products without sophisticated technology, and its main comparative advantages lie

COMPOSITION OF TRADE FOR CHINA, USA AND JAPAN IN 2002 Table 3

Percentages	China		Japan		USA	
	Exports	Imports	Exports	Imports	Exports	Imports
Agricultural products	5.8	7.4	1.1	16.7	10.4	6.2
Mining products	4.2	11.9	1.7	24.7	3.7	12.5
Manufactures	90.0	80.7	97.2	58.6	85.9	81.3
Iron and steel	*1.0*	*4.6*	*3.9*	*0.7*	*0.9*	1.4
Chemicals	*4.7*	*13.3*	*8.3*	*7.7*	*12.3*	7.7
Other semi-manufactures	*7.8*	*4.9*	*4.5*	*4.4*	*6.3*	7.3
Mach. and transp. equip.	*39.1*	*46.7*	*70.2*	*28.5*	*52.8*	44.8
Clothing and textiles	*19.0*	*4.9*	*1.6*	*6.7*	*2.5*	7.3
Other consumer goods[1]	*18.4*	*6.3*	*8.6*	*10.6*	*11.1*	12.8
Total	100.0	100.0	100.0	100.0	100.0	100.0
Total merchandise (billion USD)[2]	324.9	293.6	398.8	330.5	662.1	1,149.2

Source: International Trade Statistics 2003, WTO.

1 Including household articles, footwear, photo equipment, watches.

2 Excluding unspecified products.

FOREIGN DIRECT INVESTMENTS IN SELECTED COUNTRIES — Table 4

Billion dollars	1992	1994	1996	1998	2000	2002
China	11.2	33.8	40.2	43.8	40.8	52.7
USA	18.9	45.1	84.5	174.4	314.0	30.0
Japan	2.8	0.9	0.2	3.2	8.3	9.3
Singapore	2.2	8.6	8.6	7.6	12.5	7.7
India	0.2	1.0	2.5	2.6	2.3	3.4
Korea	0.7	1.0	2.3	5.4	9.3	2.0
Taiwan	0.9	1.4	1.9	0.2	4.9	1.4
Indonesia	1.8	2.1	6.2	-0.4	-4.6	-1.5
World	175.8	256.0	386.1	686.0	1,393.0	651.2
Memo: Denmark	1.0	5.0	0.8	7.7	32.8	6.0

Source: UNCTAD (World Investment Report).

within leather products, clothing, textiles, and to some extent IT and consumer electronics.[1] As regards high-technology exports, Malaysia, the Philippines and Singapore are the frontrunners, and China has not reached the level of the USA and Japan.[2] Nonetheless, the transition is underway, and high-technology products can be expected to gain considerable ground in the years to come. High-technology products as a percentage of exports doubled from 1995 to 2001, investments in research and development are rapidly increasing, and currently approximately 700,000 new engineers graduate every year.

Foreign direct investments

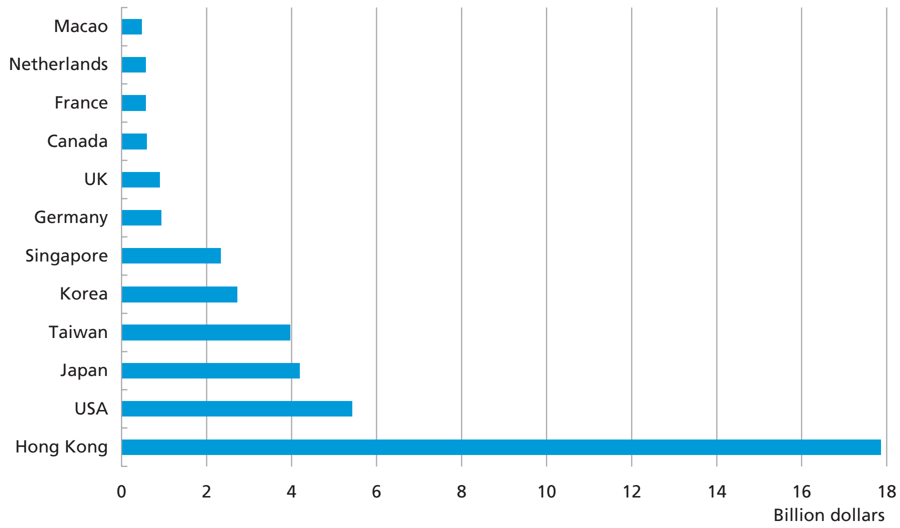
Foreign direct investments have been an important element of China's opening to the outside world. The rules were originally very restrictive, but they have been relaxed gradually, and investments have become attractive via tax incentives and information campaigns. At the same time wages are low, and certain industries have been liberalised. Foreign direct investments were more or less non-existent in the late 1970s, but accounted for just over 4 per cent of GDP in 2002.

Foreign direct investments are difficult to calculate and tend to fluctuate from year to year, but investments in China rose steadily during the 1990s, cf. Table 4. In a global perspective the USA has for many years been the largest recipient of foreign direct investments, but in 2002 China reached a level of almost 53 billion dollars and thus surpassed the USA. For the USA foreign direct investments were particularly low in 2002 against the background of the weak cyclical position. The devel-

1 Cf. International Trade Center (UNCTAD/WTO). Comparative advantages are calculated using the Balassa formula. For the sectors specified the share of world exports is significantly higher than the sector's share of national exports (1.72-4.53).

2 Cf. the World Bank.

COUNTRY OF ORIGIN OF FOREIGN DIRECT INVESTMENTS IN CHINA IN 2002 Chart 2



Note: The above 12 countries account for an accumulated 76.8 per cent of foreign direct investments in China in 2002.
Source: National Bureau of Statistics of China.

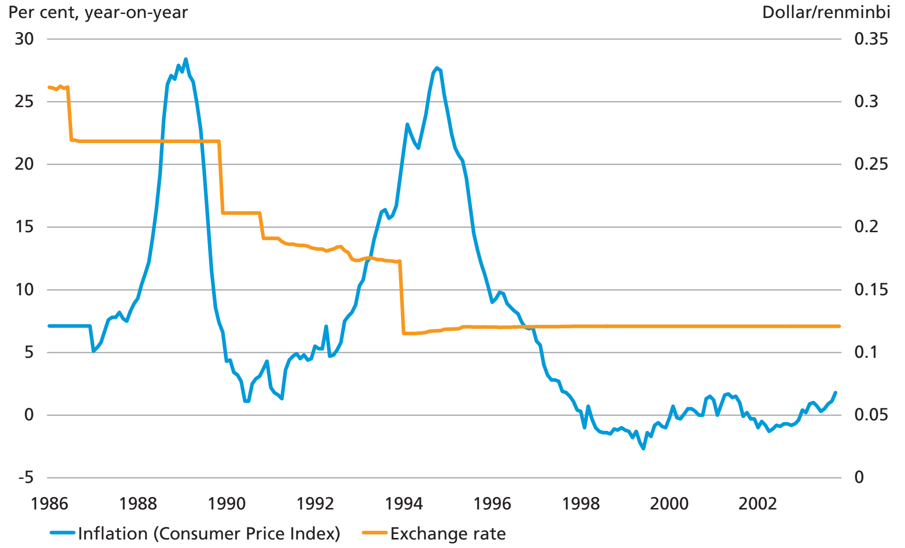
opment in China means that in absolute terms the country has reached the level typically seen in the large European countries. The other countries in Asia are not large recipients of foreign direct investments.

In the first years, Hong Kong and Taiwan were the major investors in China, but gradually multinationals from the USA, Europe and Japan have also begun to play a large role.[1] Hong Kong accounts for a third of the foreign direct investments, which is more than three times as much as the second-largest investor, the USA, cf. Chart 2. Practically all investments have been made in Eastern China, where the Chinese authorities have designated special economic zones that were initially given permission to introduce extensive liberalisation measures. Investments were not able to spread to other parts of China until the 1990s.

US and European investors appear to be attracted by the Chinese market potential, while Hong Kong and Taiwan investors tend to be more export-oriented focusing on cost benefits, particularly low wages. More than half of China's merchandise exports are manufactured by foreign-invested companies.[2] For all foreign investors the open and liberal attitude of the Chinese authorities, i.e. easy access and various preferential schemes e.g. in relation to taxation, is considered to be decisive, how-

1 Cf. Wanda Tseng and Harm Zebregs (2002) Foreign Direct Investments in China: Some Lessons for other countries. *IMF Policy Discussion Paper.*
2 Cf. JP Morgan Special Report (2003), Understanding China's trade.

INCREASE IN CHINA'S CONSUMER PRICE INDEX AND EXCHANGE RATE Chart 3



Source: EcoWin.

ever.[1] The preferential schemes are a major reason why investments in China are far higher than investments in e.g. India, which also offers low wages and a large, promising market. Most studies indicate a strong correlation between foreign direct investments and GDP growth in China. Investors are attracted by the enormous market potential and thus reinforce the growth trend. Foreign direct investments are thus estimated to have contributed almost 3 percentage points annually to China's growth in the 1990s.[2]

Financial conditions

Chinese capital restrictions have traditionally been extensive and modifications are introduced at a very slow pace. Since 1994 China has in practice maintained a fixed-exchange-rate policy vis-à-vis the US dollar within a band of ± 0.3 per cent, which was narrowed to ±0.02 per cent after the Asian crisis.[3] If an equilibrium is not immediately reached, the central bank intervenes to absorb excess supply or demand. The Chinese currency, the renminbi, is only partially convertible, and merely a few selected banks may trade in the market. Enterprises must to a large extent deliver foreign exchange to one of these banks and conduct trans-

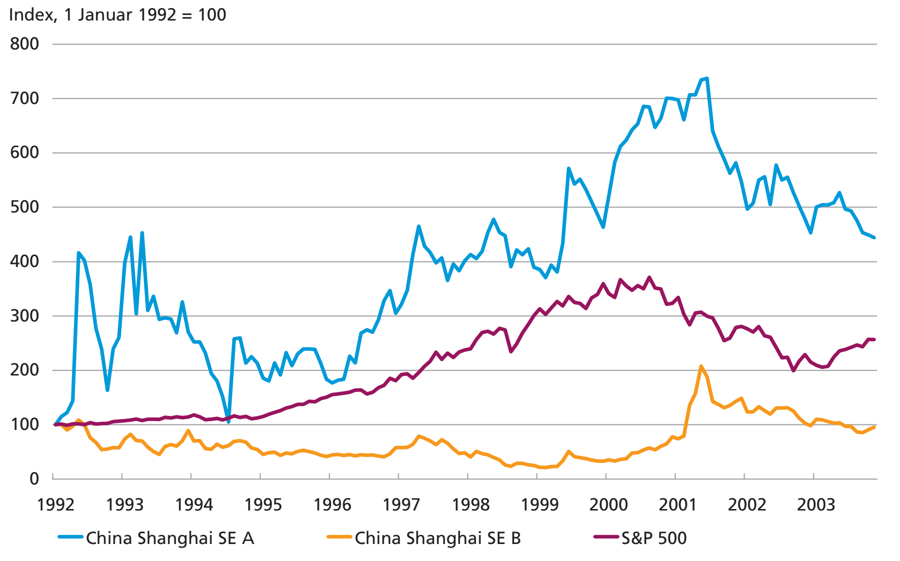
1 Some of the investments are also considered to result from round-tripping, i.e. Chinese capital that returns to China as foreign investments in order to benefit from these schemes.
2 Cf. Harm Zebregs (2003): Foreign Investment and Output Growth. IMF: China Competing in the Global Economy.
3 Cf. Nicolas Blancher (2003): Exchange Rate Policy. IMF: China Competing in the Global Economy.

actions via them. The capital restrictions are only slowly being relaxed. The period since 1978 has seen periods of high inflation and weakening of the renminbi, which the fixed-exchange-rate policy put an end to in 1994, cf. Chart 3.

The financial sector is dependent on the capital restrictions. At the end of 2002 the financial system had non-performing loans corresponding to 45 per cent of GDP, almost 560 billion dollars. Most of the non-performing loans are held by banks, where 21 per cent of loans were non-performing in mid-2003, equivalent to 30 per cent of GDP. The problem is most significant in the four large state-owned commercial banks, which have granted loans to e.g. large, unprofitable state-owned enterprises, most of which are unable to service the loans. Nonetheless a financial opening is imminent, since the WTO commitments entail full market access for foreign banks by the end of 2006.

Foreign investors' access to investing in Chinese securities is gradually improving. The Chinese stock market comprises A and B shares. Traditionally A shares have been denominated in renminbi and reserved for domestic investors, but since December 2002 certain foreign financial institutions have also been able to purchase A shares. So far this has not had any major impact on the development in the stock index, cf. Chart 4, presumably because the institutions must meet stringent conditions to be granted permission, and subsequent stock trading is subject to numerous restrictions.

DEVELOPMENT IN CHINESE STOCK MARKET Chart 4



Note: Monthly observations (averages). Latest observation 14 November 2003.
Source: EcoWin.

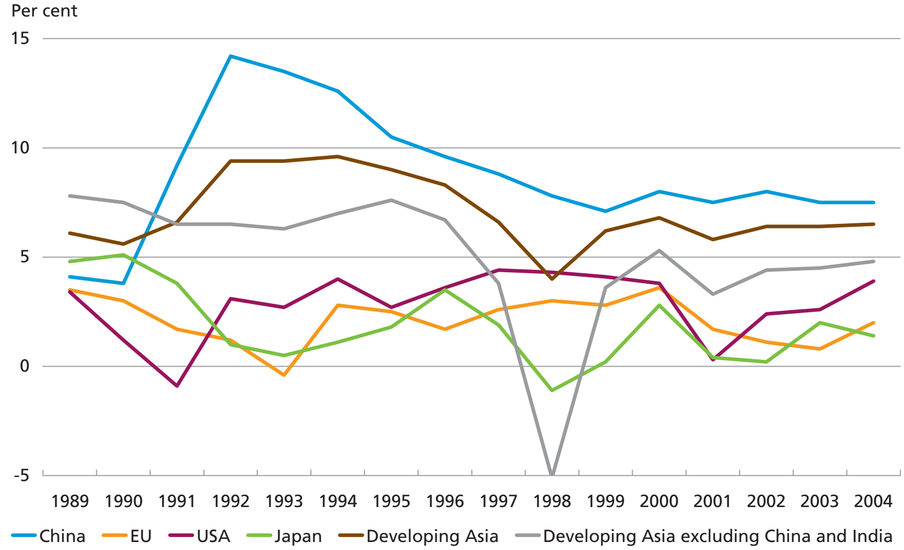
Likewise, B shares, which are denominated in US dollars and Hong Kong dollars, were formerly reserved for foreign investors. Domestic investors were given access to trading B shares at the beginning of 2001, and prices doubled in two months. Combined with a high level of savings in China, this indicates that relaxation of the capital restrictions imposed on domestic investors could lead to significant capital outflows from China.

CONSEQUENCES FOR THE REST OF THE WORLD

China's economic development has given rise to fears that growth is taking place at the expense of other countries, including the Asian countries. Neither the Asian crisis in 1997-98 nor the global economic stagnation in the last couple of years has prevented the Chinese economy from growing.

In the 1990s growth in China was far higher than in most other countries worldwide, and this trend is expected to continue, *inter alia* as a consequence of China's development stage and the possibility of benefiting from catching-up effects, cf. Chart 5. Nonetheless, most countries in Asia have also seen high economic growth rates compared with the rest of the world. Except during the Asian crisis, growth rates in the USA,

ANNUAL REAL GDP GROWTH FOR SELECTED COUNTRIES | Chart 5



Note: Developing Asia: Afghanistan, Bangladesh, Bhutan, Brunei, Cambodia, China, Fiji, India, Indonesia, Kiribati, Laos, Malaysia, Maldives, Myanmar, Nepal, Pakistan, Papua New Guinea, Philippines, Samoa, Solomon Islands, Sri Lanka, Thailand, Tonga, Vanuatu and Vietnam.

Source: IMF.

SELECTED COUNTRIES' PERCENTAGES OF GLOBAL EXPORTS						Table 5
	1992	1994	1996	1998	2000	2002
China	2.28	2.85	2.85	3.40	3.91	5.12
USA	11.93	12.07	11.75	12.60	12.10	10.91
Japan	9.07	9.31	7.76	7.18	7.50	6.56
Korea	2.04	2.27	2.59	2.46	2.69	2.54
Taiwan	2.17	2.21	2.19	2.05	2.32	n.a.
Singapore	1.69	2.28	2.36	2.04	2.16	1.97
Indonesia	0.91	0.94	0.94	0.90	0.97	0.90
India	0.49	0.57	0.61	0.67	0.69	0.79
World	100	100	100	100	100	100
Memo: Denmark	1.12	0.94	0.89	0.89	0.80	0.70

Source: IMF (Direction of Trade Statistics).

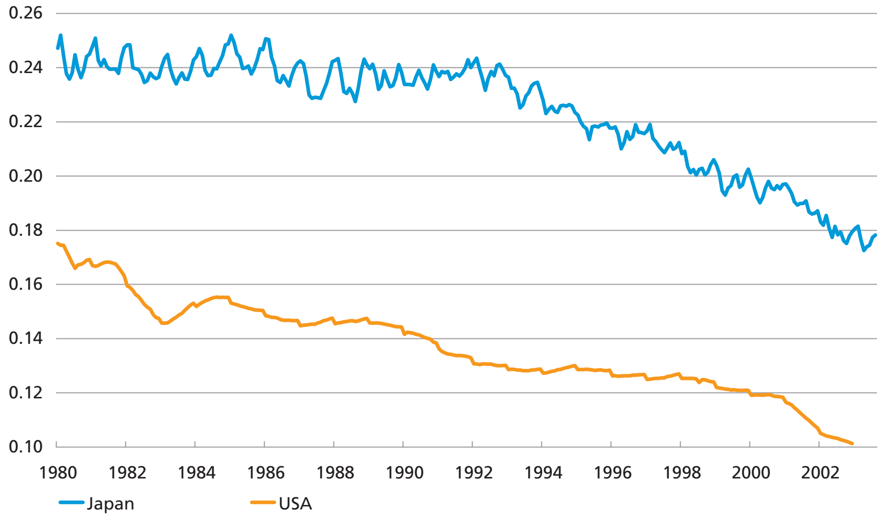
EU and Japan have been significantly lower than in the Asian countries. During the last 20 years new production patterns have emerged in Asia, where labour-intensive industries are moving from newly industrialised Asian countries (Hong Kong, Korea, Singapore and Taiwan) to e.g. China. This has not had a negative impact on welfare.[1] According to the World Bank the increasing trend in gross national income per capita (constant prices) in the newly industrialised Asian countries has continued, even after the Asian crisis and China's opening to the world.

As regards *exports*, several Asian countries – unlike China – have lost export shares, cf. Table 5. It should, however, be noted that China typically has trade deficits vis-à-vis a number of Asian countries, including Taiwan, Korea, Malaysia, Thailand and the Philippines.[2] In the first months of 2003 the top-ten list of China's bilateral trade deficits included these countries and Japan.[3] As regards *foreign direct investments*, the increasing investments in China have not led to lower investments in the rest of Asia.[4] Japan, Korea and Taiwan have seen increases since 1995, cf. Table 4. Indonesia has had problems, which should be seen against the background of, *inter alia*, the terrorist attack on Bali and the general economic and political situation in Indonesia. Domestic factors are key to foreign direct investments and, as mentioned previously, China has chosen to introduce favourable schemes.

Among the more affluent countries there has been some concern that manufacturing jobs would be lost to China, and the USA has announced its intention to impose a cap on Chinese textiles. In the USA and Japan employment in manufacturing constitutes a diminishing percentage of total employment, cf. Chart 6.

1 See e.g. BIS 73rd Annual Report (2003).
2 Cf. IMF Direction of Trade Statistics.
3 Cf. Ministry of Commerce of the People's Republic of China.
4 See e.g. Deutsche Bank (2003): China as potential superpower: Regional responses.

PROPORTION OF THE LABOUR FORCE EMPLOYED IN MANUFACTURING Chart 6



Source: EcoWin and the World Bank.

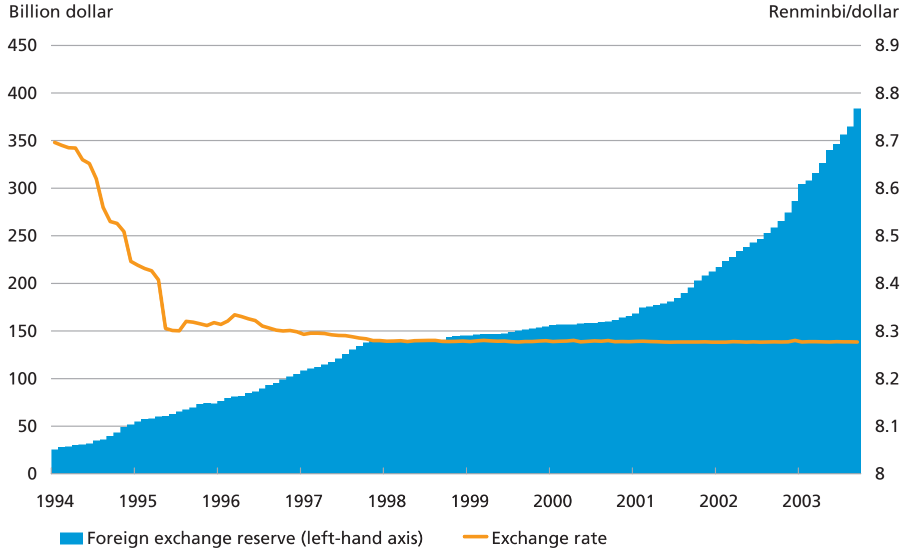
Nonetheless, calculations indicate that only a very small proportion of the development in the USA and Japan is attributable to China.[1] The decline in employment in manufacturing is primarily a result of increased productivity and welfare, which in turn boost demand for services. For instance, productivity in US manufacturing doubled from 1980 to 2001.[2]

In addition, Japan has criticised China for exporting deflation and called for an upwards adjustment of the renminbi. The problem is presumably exaggerated since the deflationary effects primarily relate to lower-priced manufactures, which constitute a relatively small proportion of the consumer price indices in the other Asian countries. Most Asian countries also apply flexible exchange-rate regimes enabling inflation targeting.[3] Finally, deflation has now been replaced by slight inflation in China, measured by consumer prices. This development is expected to continue in the coming years.

Recently the USA has criticised China's fixed-exchange-rate policy and called for a more flexible renminbi. The dollar has fallen significantly in 2003, and the renminbi has followed suit. The USA has assessed that the Chinese economy is strong and that the renminbi is undervalued, e.g. against the background of the rapidly growing foreign-exchange re-

1 See e.g. UBS (2003) Outsourcing, Shmoutsourcing.
2 Cf. Ecowin, output per hour.
3 However, Hong Kong and Malaysia, among others, have tied their currencies to the dollar.

CHINA'S FOREIGN-EXCHANGE RESERVE AND NOMINAL EXCHANGE RATE Chart 7



Source: EcoWin.

serve, cf. Chart 7. Estimations indicate that the renminbi is undervalued by 15-25 per cent.[1]

The USA's and Japan's focus on China reflects the fact that China is a major trading partner. For many years the USA's largest trade deficit was vis-à-vis Japan. However, in 2000 China took over this position, and in 2002 the USA had a deficit of 103 billion dollars vis-à-vis China, which is far more than it ever had vis-à-vis Japan, cf. Chart 8.[2] In 2002 China was the third largest exporter to the USA after Canada and Mexico. For Japan, the USA has been the largest trading partner for many years, both in terms of imports and exports, but in 2002 China became the primary source of Japanese imports. Denmark's trade deficit vis-à-vis China is also increasing, and was just under kr. 7 billion in 2002.[3] Generally China's large trade surplus vis-à-vis the USA is not typical of bilateral trade between China and other countries, since China's total trade surplus was approximately 30 billion dollars in 2002, i.e. far below the surplus vis-à-vis the USA.[4]

An adjustment of the renminbi will not necessarily imply a significant positive effect on the US balance of trade. In the period 1995-2001 the

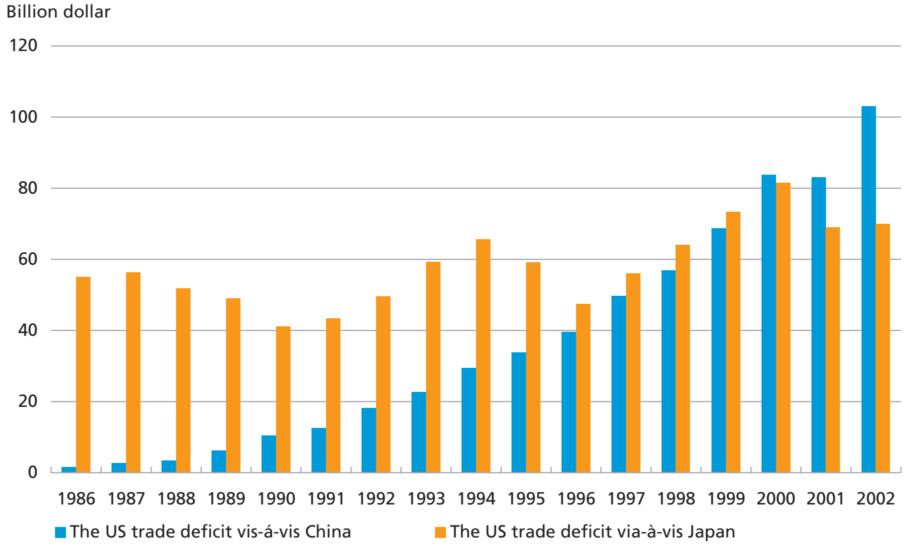
1 See e.g. Morris Goldstein (2003), China's Exchange rate regime.

2 According to the IMF Direction of Trade Statistics, China's trade surplus vis-à-vis the USA was 43 billion dollars in 2002. There are generally large differences in the calculations from respectively China and its trading partners owing to Hong Kong's major significance to China's trade.

3 Cf. Statistics Denmark, *Statistical Yearbook* 2003.

4 Cf. IMF Direction of Trade Statistics.

THE US BALANCE OF TRADE VIS-À-VIS CHINA AND JAPAN Chart 8



Source: U.S. Census Bureau.

real effective dollar rate strengthened by more than 30 per cent.[1] In the same period the USA's merchandise imports from China increased by an annual average of 15 per cent, even though the annual average increase in the USA's total merchandise imports was only 8 per cent.[2] US importers have thus perceived Chinese products as relatively "cheap" although the renminbi – unlike many other currencies – kept up with the strengthening of the US dollar. The significant Chinese exports to a large extent reflect productivity gains and comparative advantages in the form of low production costs. The Institute for International Economics has assessed that an upwards adjustment of the renminbi by 20 per cent, combined with a revaluation of 10 per cent in the other Asian emerging market economies and Japan would improve the USA's balance of payments by 50 billion dollars[3], equivalent to only one tenth of the total US balance-of-payments deficit in 2002.

It is also arguable to what extent the renminbi is undervalued. The Chinese balance-of-payments surplus has only averaged approximately 2 per cent since 1995, and it is vulnerable in view of the adaptations of the economy which must necessarily take place because of the WTO commitments and the high growth in investments that are prerequisites of continued catching-up. Moreover, the build-up of the foreign-exchange

1 Cf. EcoWin.
2 Cf. U.S. Census Bureau.
3 See e.g. Morris Goldstein (2003), China's Exchange rate regime.

reserve is mainly attributable to the development in foreign direct investments. For instance, the foreign-exchange reserve increased by 60 billion dollars in the 1st half of 2003, while the merchandise trade surplus was 6.9 billion dollars and foreign direct investments were 26 billion dollars.[1] Finally, it is generally difficult to determine the "correct" exchange rate. The real effective exchange rate for the renminbi in mid-2003 was slightly higher than the 1990 level after having been significantly higher in the intervening years, e.g. 14 per cent higher in 2001 on average. An equivalent trend is seen for the dollar, which is also back at the 1990 level. The level of the euro is approximately 15 per cent lower, while the yen is approximately 5 per cent higher than in 1990.[2]

In the short term the problems with e.g. non-performing loans in the financial sector imply that floating the renminbi – which requires abolishment of the capital restrictions and thus entails risk of a significant outflow of capital and a financial crisis – would not necessarily strengthen it. Much of the discussion is therefore focused on the strategy for increasing the flexibility of the renminbi. Most experts believe that the first step should be a revaluation of the renminbi, a widening of the fluctuation band and/or pegging to the US dollar, yen and euro, not merely the dollar, while actual floating of the renminbi should not take place for some time yet.[3]

The Chinese authorities have indicated that the fixed-exchange-rate policy will be maintained for the time being, but that they are considering widening the fluctuation band, as well as pegging the renminbi to a basket of currencies. At present the focus areas are economic growth and the required structural reforms, which may cause major problems, including in the financial sector and the labour market. The government budget is facing major challenges in view of the non-performing loans held by the state-owned banks, the restructuring of the state-owned enterprises, and the need to expand the social security system. Privatisations entail risk of social unrest since the state-owned enterprises constitute a social welfare system.

SUSTAINED GROWTH IN CHINA?

So far China has experienced impressive economic and political development as a result of a new Chinese attitude to the rest of the world, as well as extensive reforms of China's economy. The economic growth in

1 Cf. JP Morgan.
2 Cf. EcoWin (Real Effective Exchange Rate, which also takes unit-labour costs into account).
3 See e.g. Morris Goldstein and Nicholas Lardy (2003, Institute for International Economics), Two-stage Currency Reform for China.

FACTORS CONTRIBUTING TO CHINESE GROWTH				Table 6
Percentage of GDP	1990-94	1995-99	2000-05	2006-10
Potential growth	9.7	8.7	7.2	7.5
Capital accumulation	6.4	6.4	5.7	5.9
Labour force growth	0.5	0.4	0.3	0.2
TFP growth	2.8	2.0	1.2	1.4
Actual growth	10.1	8.4	-	-

Source: Paul Heytens and Harm Zebregs (2003): How fast can China grow? IMF: China Competing in the Global Economy.

China has been due mainly to capital accumulation and increasing Total Factor Productivity (a residual growth factor), while the contribution from labour force growth has been lower, cf. Table 6. It is typical of the catching-up process that capital accumulation plays a significant role in generating economic growth. It is, however, remarkable that employment does not play any major role. Growth in employment may have been dampened as a result of the "hukou" system which for many years prevented people born in rural areas from seeking employment in the cities.[1] Incidentally, the extensive reforms have led to higher unemployment.[2]

The estimations render it plausible that China can sustain a growth rate of 7-8 per cent in the coming years.[3] China's possibilities of transferring labour force from low-productivity to high-productivity industries will be considerable for many years to come, since streamlining has so far primarily taken place in specially designated small economic zones. Historically newly industrialised Asian countries such as Taiwan and Korea have been able to sustain high growth rates for many years.

At an annual growth rate of 7-8 per cent, China's GDP will double every 10 years. China can therefore be expected to play a still larger role in the global economy – not only as an exporter, but also as an importer – and to provide access to a market with 1.3 billion new consumers.[4] However, there is still a long way to go before China's weight in the global economy will reflect its actual size. If China can sustain an average annual growth rate which is 3 percentage points above that of the

1 Some restrictions have been abolished so rural citizens can be employed in cities, but access to e.g. education, health and social services is still subject to the hukou system. According to the World Bank, approximately 60 per cent of the Chinese population lives in rural areas.

2 Officially the unemployment rate has been 2-4 per cent during the last 20 years (cf. the International Labour Organisation), but at the end of 2002 the Chinese government acknowledged that unemployment was at least 7 per cent and rising.

3 The reliability of the Chinese statistics has often been questioned, and some observers believe that growth is overestimated, cf. Poul Heytens and Harm Zebregs. Goldman Sachs, however, rather believes growth in recent years to be underestimated. In early November 2003 Lawrence Klein said, "My position is that the China numbers are credible".

4 From 1998 to 2001 the number of PCs per 1,000 persons increased from 8.9 to 19, the number of Internet users increased from 2.1 million to 33.7 million, and the number of telephones per 1,000 persons increased from 88.6 to 247.7 according to the World Bank.

global economy, it will take 40 years before China's share of global GDP reaches the level of 12 per cent where Japan's was in 2002, and almost 60 years before China's GDP – like its population in 2002 – accounts for a fifth of the global GDP.