# China can sustain long-term growth, with a few changes at home

Domestic structural change is necessary if the Peoples Republic of China is to sustain economic growth of as high as 8% a year over the next 10 years.

Research published in an Asian Development Bank Institute book, *Slowdown in the People's Republic of China, Structural Factors and the Implications for Asia,* found the worldwide trade slowdown that followed the global financial crisis in 2008 is mostly to blame for the recent decline in China's growth rate.

Peter Morgan, co-chair of the Research Department at ADBI, says China will need to switch its focus to domestic growth to offset the diminished role of global trade in its economy.

> China's economy still has plenty of areas for industrial upgrading and reform that could support growth, including reform of the capital market, strengthening of the social welfare system, and support for innovation. The key is to promote needed domestic economic and financial reforms to offset the negative drags on growth from overseas.

Morgan says pessimists see China's slowdown as the beginning of the end of its high-growth era, and that past years of high growth were mostly due to capital investments that have now run their course.

> Pessimists also tend to emphasize structural factors limiting China's growth potential such as declining labor force, end of surplus agricultural labor, and policy distortions, while optimists emphasize the scope for further reforms to boost growth, positive macroeconomic conditions, and continued investment opportunities. China still has many positive supply factors that, under the favorable circumstances, could support a relatively high-potential growth rate in the medium term.



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Key to that optimism are two ideas, Morgan says.

The first is that much of China's slowdown is due to the global slowdown in trade. Comparing the experience of other Asian countries, the study finds similar or even worse slowdowns took place in China's neighbors at the same time, which is seen as evidence against the premise that China's slowing growth is primarily a homegrown problem.

Second, China's potential for continued high growth can be seen by comparing the relative incomes of its people with those in developed countries. Growth will likely slow once incomes converge but that may take some time yet.

> **In 2008, China's per capita income was just over one-fifth that of the US. This is approximately equal to the gap between the US and Japan in 1951, and Japan grew at an average annual rate of 9.2% over the following 20 years. Following a similar gap with the US in 1977, the Republic of Korea grew at 7.6% per year for 2 decades, while Singapore in 1967, and Taipei,China and China in 1975 had similar gaps and growth experiences. Following these examples, in the 20 years after 2008, China could have a potential growth rate of as much as 8%, although this pace is likely to slow in the second half of that period.**

China still has a latecomer advantage, whereby it can import, imitate, or license new technologies from more developed countries to upgrade its industries.

Its consumers are big savers and those savings can be tapped to improve urban infrastructure. Reforms to make it easier for people to move to cities would also help growth.

> **Considering the advantages of China's large domestic market, highly entrepreneurial culture, innovative public, and well-developed competition, these kinds of investments should offer a lot of opportunities with high rates of return.**

Morgan says China is taking steps to improve its environment and that could pay off both in the quality of life and in the industrial advantage China could gain by being a leader in the field.


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The third major area to support investment growth is a cleaner environment. It's clear that the process of rapid economic development in China has led to serious environmental problems. Environmental laws must be enforced. The introduction of new energy-saving and less-polluting production equipment is an area of investment with high social returns.

That was Peter Morgan, co-chair of the Research Department at the Asian Development Bank Institute. He edited *Slowdown in the People's Republic of China, Structural Factors and the Implications for Asia* with Justin Yi-fu Lin, director of the Center for New Structural Economics, Peking University, China, and Guanghua Wan, director of the Institute of World Economy, Fudan University, China. This is part four of a five-part podcast series on the book.

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